Supreme Court, U.S.
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No. 02-593

IN THE

Supreme Court of the United States

Hall Holding Company, Inc., David L. Goldman, Kathleen A. Keating, George P. Ahearn, Michael F. Shields, Goldman Financial Group, Inc.,
Petitioners,

v.

Elaine Chao, Secretary, U.S. Department of Labor,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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163 pp

QUESTION PRESENTED

Whether the court below was correct when it declined to follow other circuit court opinions and held that it may, without requiring proof of causation, assess liability and damages against a fiduciary who allegedly violated the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

LIST OF PARTIES

Petitioners:

Hall Holding Company, Inc.

David L. Goldman

Kathleen A. Keating

George P. Ahearn[1]

Michael F. Shields

Goldman Financial Group, Inc.

Respondent:

Elaine Chao,
Secretary of the United States Department of Labor

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[1] The caption of the Court of Appeals' opinion incorrectly states Mr. Ahearn's middle initial.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court R. 29.6, petitioners Hall Holding Company, Inc. and Goldman Financial Group, Inc. each state that there is no parent corporation or publicly held company owning 10% or more of its stock.

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IN THE

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Opinions Below

The opinion of the United States Court of Appeals for the Sixth Circuit is published at 285 F.3d 415, 27 Employee Benefits Cas. (BNA) 2153, Pens. Plan Guide (CCH) ¶ 23978E (6th Cir. 2002) and is reproduced at Petitioners' Appendix (hereafter "Pet. App.") 1a-56a. Two opinions of the United States District Court for the Northern District of Ohio are published at 990 F. Supp. 955, 1998 U.S. Dist. LEXIS 2957, 21 Employee Benefits Cas. (BNA) 2770 (N.D. Ohio 1998) and 60 F. Supp.2d 755, 1999 U.S. Dist. LEXIS 12448 (N.D. Ohio 1999), while the other three opinions are unreported. The District Court's opinions are reproduced at Pet. App. 57a-85a and 98a-131a. The Report and Recommendation of the United States Magistrate Judge in the District Court proceedings is reproduced at Pet. App. 86a-97a and is unreported. The Sixth Circuit's order denying Petitioner Kathleen A. Keating's request for

rehearing is published at 2002 U.S. App. LEXIS 14761 (6th Cir. July 18, 2002) and is reproduced at Pet. App. 132a.

Jurisdiction

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The Sixth Circuit Court of Appeals filed its opinion on April 3, 2002. Following petitioner Kathleen A. Keating's timely request for a rehearing, the Sixth Circuit filed its order denying the request for rehearing on July 18, 2002.

Statutory Provisions Involved

The statutory provisions involved in the case are Sections 3(18)(B), 404(a)(1)(B), 406(a)(1)(A) and (D), 408(e)(1), 409(a), and 502(a)(2) of ERISA, 29 U.S.C. §§ 1102(3)(18), 1104(a)(1)(B), 1106(a)(1)(A) and (D), 1108(e)(1), 1109(a) and 1132(a)(2).[1]

ERISA § 404(a)(1)(B) provides, in relevant part:

> (a)(1) . . . [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –
>
> . . .
>
> (B) with the care, skill, prudence, and diligence under the circumstances then

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[1] Respondent initially asserted jurisdiction under both ERISA § 502(a)(2) and ERISA § 502(a)(5), but never pursued her claim for relief under ERISA § 502(a)(5).

prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims[.]

ERISA § 406(a)(1)(A) and (D) provide:

(a) Except as provided in section 408:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect –

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

. . .

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan[.]

ERISA § 408(e)(1) provides, in relevant part:

(e) Sections 406 and 407 shall not apply to the acquisition . . . by a plan of qualifying employer securities (as defined in section 407(d)(5)) . . . –

(1) if such acquisition . . . is for adequate consideration . . . .

ERISA § 3(18)(B) provides, in relevant part:

> The term "adequate consideration" when used in part 4 of subtitle B means . . . (B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary.

ERISA § 502(a)(2) provides:

> (a) A civil action may be brought –
> . . .
> (2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 409[.]

ERISA § 409(a) provides, in relevant part:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach. . . .

Statement of the Case

In 1990, Petitioner Goldman Financial Group Inc. ("GFGI") decided to enhance the pension program for employees of Hall Chemical Company, its indirect subsidiary and the sole operating subsidiary of Petitioner Hall Holding Company, Inc., to provide employees with a

small stake in their company. To accomplish these goals, Petitioner David Goldman, the controlling shareholder of Hall Holding and GFGI through various trusts and corporations, authorized the creation of the Hall Chemical Company, Inc. Employee Stock Participation Plan (the "Hall ESOP") and ultimately agreed to sell 9.96% of the Hall Holding stock to the Hall ESOP.

In order to determine the value of Hall Holding stock, which was not publicly traded, GFGI retained James Cunningham, a prominent investment banker and recognized expert in the specialty chemical industry to value Hall Chemical, Hall Holding's only material asset. Mr. Cunningham concluded that the value of Hall Chemical, excluding debt, was between $32.7 and $37.7 million. Following their extensive review of Mr. Cunningham's valuation, Petitioner Kathleen A. Keating, GFGI's Director of Human Resources who was intimately involved in the creation of the Hall ESOP, and the Hall ESOP trustees, Petitioners George P. Ahearn and Michael F. Shields, respectively the President and Chief Operating Office, and Chief Financial Officer of Hall Chemical, decided that the Hall ESOP would be willing to pay $3.5 million for 9.96% of the Hall Holding stock. Petitioners arrived at this purchase price by taking the approximate midpoint of Mr. Cunningham's valuation range, multiplying that number by 9.96%, and rounding the result.

Respondent filed a complaint in the United States District Court for the Northern District of Ohio alleging, among other things, that Petitioners, as fiduciaries of the Hall ESOP, caused the ESOP to engage in a transaction prohibited under ERISA §§ 406(a)(1)(A) and (D) because the purchase price the Hall ESOP paid for the stock exceeded "adequate consideration," as that term is defined in Section 3(18) of ERISA, 29 U.S.C. § 1002(18). Although

ERISA §§ 406(a)(1)(A) and (D) generally prohibit benefit plans from purchasing employer stock, ERISA § 408(e)(1) exempts purchases of "qualifying employer securities" provided that the purchase is for "adequate consideration" as defined in ERISA § 3(18). ERISA § 3(18)(B) defines "adequate consideration" as "in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the . . . named fiduciary. . . ."

After a considerable discovery period, Respondent moved for summary judgment, contending that the Hall ESOP fiduciaries did not conduct a sufficient inquiry into the price of the stock, and, in fact, overpaid by approximately $2.6 million. The District Court denied Respondent's motion. Although it agreed with Respondent that Petitioners had not conducted a prudent investigation, the District Court ruled that summary judgment was not appropriate under the Sixth Circuit's holding in Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995), because there was no proof of causation in the form of evidence in the record as to whether an objective, reasonable fiduciary would have paid the same price that Petitioners paid for the Hall ESOP stock. Following Respondent's motion for reconsideration, the District Court reversed itself and held that it was unnecessary to establish causation under prohibited transaction provisions of ERISA. In so doing, the District Court rejected as irrelevant Petitioners' evidence that a hypothetical prudent fiduciary would have paid the same price for the Hall Holding stock as did the Hall ESOP, and instead directed the Magistrate Judge to determine the fair market value of the Hall ESOP stock for purposes of calculating damages.

After hearing testimony from Mr. Cunningham, some of the Petitioners and each party's valuation expert, the Magistrate Judge issued a Report and Recommendation in

which he concluded that Mr. Cunningham was not only "a recognized expert in evaluating companies in the specialty chemical industry," but that his valuation of Hall Chemical, which set forth a range of value, was reasonable. However, because of the District Court's ruling, the Magistrate Judge declined to consider the only evidence presented on what a hypothetical reasonable fiduciary would have paid for the Hall Holding stock and instead proceeded to perform his own valuation. Specifically, the Magistrate Judge adopted adjustments to the Cunningham valuation and concluded that the fair market value of the stock was exactly $2,731,174.75.

After both parties challenged the Magistrate Judge's Report and Recommendation, the District Court held another evidentiary hearing at which the court again refused to consider evidence on what price a hypothetical prudent fiduciary would have paid for the Hall ESOP stock. The District Court also decided to perform its own de novo valuation of the Hall Holding stock, and arrived at a "fair market value" of exactly $2,450,451.00. The District Court then issued a series of orders holding Petitioners personally liable for monetary damages to the Hall ESOP in the approximate amount of $1.1 million, together with prejudgment interest.

On appeal, Petitioners pointed to a number of errors committed by the District Court. In particular, Petitioners argued that to determine whether there had been a violation of ERISA, the court was required to establish causation: that the conduct had actually caused a loss to the Hall ESOP. Based on well-accepted precedent from the Sixth Circuit and other Courts of Appeal, causation in ESOP and other stock cases requires a court to determine what a hypothetical prudent fiduciary would have paid for stock, i.e., whether the purchase price was objectively reasonable. The Sixth Circuit rejected this argument, concluding that a fiduciary's failure

to conduct a prudent investigation alone was sufficient to establish a violation of ERISA § 406(a), even if a reasonable fiduciary would have paid the same price. Chao v. Hall Holding Co., Inc., 285 F.3d 415, 434 (6th Cir.), reh'g denied, 2002 U.S. App. LEXIS 14761 (6th Cir., July 28, 2002) (Pet. App. 34a) ("a violation of § 406 is a per se violation, notwithstanding the price a reasonable hypothetical fiduciary would have paid for the stock."). In adopting this construction, the Sixth Circuit announced that it was explicitly rejecting the Eighth Circuit's decision in Herman v. Mercantile Bank, N.A., 143 F.3d 419 (8th Cir.), reh'g, en banc, denied, 1998 U.S. App. LEXIS 20331 (8th Cir. July 28, 1998). Chao v. Hall Holding Co., Inc., 285 F.3d at 436 (Pet. App. 380).

Petitioners also argued that even if a fiduciary's failure to conduct an adequate investigation into the price of employer stock, standing alone, is sufficient to show a violation of ERISA § 406(a), it does not necessarily follow that the plan suffered a monetary loss from the violation. Petitioners contended that some finding of causation was required to determine whether the violation in fact harmed the plan: if the court found that the hypothetical prudent fiduciary would have paid the same price as the fiduciaries actually paid, then the plan suffered no harm and there is no basis for imposing monetary liability on the fiduciary. The Sixth Circuit rejected this argument, reasoning that in enacting flat prohibitions on certain types of transactions, regardless of their actual effects on plans, Congress intended to establish a "per se" violation rule that does not require a showing of a "causal link" between a fiduciary's failure to investigate and any harm suffered by the plan. Chao v. Hall Holding Co., Inc., 285 F.3d at 438-439 (Pet App. 43a-44a). Having removed the objective "hypothetical prudent fiduciary" test from the equation, the Sixth Circuit concluded that the Hall ESOP suffered a loss simply because the

District Court determined a lower value for the Hall Holding stock than did Petitioners (or the hypothetical prudent fiduciary or, for that matter, the Magistrate Judge).

The district court had jurisdiction over the case pursuant to Section 502(e) of ERISA, 29 U.S.C. § 1132(e).

Reasons for Granting the Writ

This case presents an opportunity to resolve several conflicts in the Circuits created by the Sixth Circuit's decision, which already has been followed by a lower court in the Sixth Circuit and been the subject of considerable press within the ERISA bar. See Horn v. McQueen, 215 F. Supp. 2d 867 (W.D. Ky. 2002); Gary S. Tell, *Chao v. Hall Holding Co., Inc.: Round Numbers Add Up to Trouble as the Sixth Circuit Dissects an ESOP Transaction*, 10 ERISA Litigation Reporter 2, 5-8 (2002).

First, as noted above, the Sixth Circuit explicitly criticized and rejected the Eighth Circuit's holdings in Herman v. Mercantile Bank, N.A., supra (hereafter, "Mercantile Bank"). That decision follows another Eighth Circuit decision, Roth v. Sawyer-Cleator Lumber Co., 16 F.3d 915, 919 (8th Cir. 1994) (hereafter "Roth"), which relied on the reasoning of then-Judge Scalia's concurring opinion in Fink v. National Sav. & Trust Co., 772 F.2d 951, 962 (D.C. Cir. 1985) (hereafter "Fink") (Scalia, J., concurring in part and dissenting in part).

Second, the Sixth Circuit's rejection of a causation requirement in ERISA § 406(a) directly conflicts with the Seventh Circuit's decision in Brock v. Robbins, 830 F.2d 640 (7th Cir. 1987), which held that fiduciaries who failed to conduct a reasonable investigation did not engage in a prohibited transaction in violation of ERISA § 406(a)

because a hypothetical prudent fiduciary would have entered into the same transaction at the same price. Like the Seventh and Eighth Circuits, we believe that causation is required for a finding of a violation of ERISA § 406(a), but whatever one's view of that question, we can see no basis for the Sixth Circuit's holding that causation is not required in order to establish damages under ERISA. That much is clear from the statutory language of Section 409(a) of ERISA, 29 U.S.C. § 1109(a), which provides that fiduciaries are personally liable only for losses to plans "resulting from" a breach of fiduciary duty.

Third, the Sixth Circuit's rationale for not requiring causation -- that claims of imprudent conduct under ERISA § 404(a) and prohibited transaction claims are analytically distinct -- conflicts with both the Seventh Circuit's decision in Brock v. Robbins, supra, and the Fifth Circuit's decision in Donovan v. Cunningham, 716 F.2d 1455 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984). Both hold that prohibited transaction cases where the critical issue is a statutory exemption based on the reasonableness of fiduciary conduct are to be adjudicated under the analytical framework established under ERISA § 404. All Circuits have held that that framework requires a finding of causation.

Finally, we urge the Court to take this case to provide guidance to the lower courts in the proper methodology for adjudicating the ever-increasing number of ESOP cases, for the decision below on causation threatens what had been the accepted judicial approach to the critical issue of valuation. By rejecting all evidence relating to what a hypothetical reasonable fiduciary would have paid for the Hall Holding stock, the court was compelled to do its own valuation of the stock. But at least since the Fifth Circuit's seminal ESOP decision in Donovan v. Cunningham, supra, the courts have been guided by the Fifth Circuit's holding that "[a] court

reviewing the adequacy of consideration under Section 3(18) is to ask if the price paid is 'the fair market value of the asset as *determined in good faith by the . . . fiduciary*; it is not to redetermine the appropriate amount for itself *de novo*." Donovan v. Cunningham, 716 F.2d at 1467 (emphasis in original). Given the fact that even valuation experts will never agree on an "actual" fair market value of closely-held stock, the lower court's approach has made ESOP valuation a trap for the unwary.

I. The Ruling Below Creates Conflicts in the Circuits.

A. The Sixth Circuit Expressly Rejected Eighth Circuit Precedent on the Exact Same Issue.

In Mercantile Bank, the Eighth Circuit held that, even if an ESOP trustee fails to make a good faith effort to determine the fair market value of closely-held employer stock, the trustee is "insulated from liability" under ERISA § 406(a) "if a hypothetical prudent fiduciary would have made the same decision anyway." Mercantile Bank, 143 F.3d at 421, quoting Roth, 16 F.3d at 919[2] In so holding, the Eighth Circuit recognized, as did the District Court and all of the experts in this proceeding, that "[d]etermining the value of a company's stock is not an exact science. This is particularly true of the stock of a closely held corporation . . . because there is no continuously operating market for such

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2 The Eighth Circuit in Mercantile Bank endorsed the district court's finding "that the fair market value of the stock, whatever it was precisely, was sufficiently close to what [the fiduciary] paid that, even if [the fiduciary] did over pay slightly [perhaps by as much as 12.6 percent], [he] had no reason to know that he was overpaying. This amounts to a finding that a hypothetical prudent fiduciary in [the fiduciary's] place could have and would have paid what [the fiduciary] paid for the stock." Mercantile Bank, 143 F.3d at 422.

stock." Mercantile Bank, 143 F.3d at 422. Thus, the Court held that ERISA cannot require a "to-the-penny" determination of fair market value, concluding that:

> In order to hold that [the fiduciary][] did not violate ERISA in [purchasing the employer stock] [], the District Court did not need to find that [the fiduciary] bought the stock for exactly, to the penny, its fair market value; the Court merely needed to find that a prudent fiduciary in [the fiduciary's] place would have paid what [the fiduciary] paid. That is what the District Court found.

Id.

Mercantile Bank relied on the Eighth Circuit's earlier decision in Roth, which involved a claim by ESOP participants that the ESOP fiduciaries violated ERISA by failing to adequately investigate whether the employer stock that secured the participants' "put options" represented adequate security. Here too the Eighth Circuit emphasized that ESOP fiduciaries do not violate ERISA as long as their pricing determinations are objectively reasonable, holding that "[e]ven if a trustee failed to conduct an investigation before making a decision, he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway." Roth, 16 F.3d at 919.

Significantly, the Roth decision explicitly rejected the notion that an ESOP could suffer any "loss" from an objectively reasonable price, even if arrived at through an imprudent analysis. The Court emphasized that "[u]nder the prudent person standard," where the fiduciaries' decision is "objectively reasonable regardless of the process by which they reached it[,] . . . there was no causal connection

between their allegedly deficient conduct and a loss to the ESOP." Id. at 919. This analysis finds its source in then-Judge Scalia's concurring opinion in Fink, 772 F.2d at 962 (Scalia, J. concurring in part and dissenting in part):

> Breach of fiduciary duty to investigate would sustain an action to enjoin or remove the trustee . . . , or perhaps even to recover trustee fees paid for the investigation and evaluative services that went unperformed. But it does not sustain an action for the damages arising from losing investments. I know of no case in which a trustee who has happened – through prayer, astrology or just blind luck – to make (or hold) objectively prudent investments . . . has been held liable for losses from those investments because of his failure to investigate and evaluate beforehand.

Id. (internal citations omitted).

B. The Sixth Circuit's Decision on Causation Also Directly Conflicts With Seventh Circuit Precedent.

The Seventh Circuit in Brock v. Robbins, supra, also reached the opposite conclusion from the Sixth Circuit concerning the relevance of the hypothetical prudent fiduciary standard to ERISA § 406(a) claims. Specifically, the Seventh Circuit held that pension plan trustees who failed to conduct a reasonable investigation as to whether the plan would be paying "reasonable compensation" for services provided to it by a party in interest did not engage in a prohibited transaction in violation of ERISA § 406(a)(1)(C) because the service contract they entered into contained "a fee provision with which a hypothetical prudent trustee

would also agree." Brock v. Robbins, 830 F.2d at 646. The Seventh Circuit reasoned that "if there actually had been a reasonable investigation by a prudent trustee, the trustee would have agreed to the fee provisions that the defendants initially agreed to." Id.

In addition to holding that there can be no prohibited transaction liability under ERISA § 406(a) in the absence of causation, the Seventh Circuit in Brock v. Robbins also held that ERISA § 409(a) does not allow for the imposition of damages against a fiduciary simply for acting imprudently, absent proof that its actions actually caused losses to the plan. In particular, the Seventh Circuit rejected the argument that monetary damages should be imposed against the trustees who entered into the service contract simply because they failed to investigate its reasonableness. The Court reasoned that "[i]f trustees act imprudently, but not dishonestly, they should not have to pay a monetary penalty for the imprudent judgment so long as it does not result in a loss to the Fund." Id. at 647.[3] The Court concluded that imposing a monetary penalty for imprudent but harmless conduct by honest trustees "will not further the primary purpose of ERISA," and in fact would not serve any statutory purpose at all, and that "[a]ny additional deterrent value created by the imposition of a monetary penalty unrelated to actual loss is marginal at best." Id. On the contrary, the Seventh Circuit observed that "No ERISA provision justifies the imposition of such a penalty. *See* 29 U.S.C. § 1109(a) (imposing personal liability only for losses "resulting from each such breach" of fiduciary responsibilities)." Id.

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[3] The District Court here concluded that Petitioners did not act dishonestly. See Reich v. Hall Holding Co., Inc., 60 F. Supp.2d 755, 765 (N.D. Ohio 1999) (Pet. App. 116a).

C. The Sixth Circuit's Distinction Between Causation in ERISA § 404(a) cases and ERISA § 406(a) Cases Places its Decision in Conflict With Other Circuits.

In addition to the Seventh Circuit in Brock v. Robbins, supra, other Circuit Courts of Appeal who have considered the issue consistently have held that proof of causation of loss to the plan is a prerequisite to imposing monetary liability under ERISA against fiduciaries who breach a statutory duty.[4] In fact, another panel of the Sixth Circuit so held in Kuper v. Iovenko, 66 F.3d at 1459 (hereafter, "Kuper"), an ESOP case in which participants alleged that the ESOP fiduciaries breached their fiduciary

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[4] See, e.g., Silverman v. Mutual Benefit Life Ins. Co., 138 F. 3d 98, 104 (2d Cir.), cert. denied, 525 U.S. 876 (1998) (ERISA § 409(a) on its face requires that a plaintiff "demonstrate in a suit for compensatory damages that the plan's losses 'result[ed] from' [defendant's] breach."); Diduck v. Kaszycki & Sons Contractors, Inc., 974 F. 2d 270, 279 (2d Cir. 1992); In re Unisys Sav. Plan Litig., 74 F.3d 420, 445 (3d Cir.), cert. denied, 519 U.S. 810 (1996); Elmore v. Cone Mills Corp., 23 F.3d 855, 864 (4th Cir. 1994) (en banc) (refusing to grant relief where plaintiffs failed to prove that the stock purchased by the plan as a result of the allegedly prohibited transaction was in fact worth less than the price for which it was appraised and where plaintiffs failed to prove that they suffered a loss); Physicians Health Choice, Inc. v. Trustees of the Automotive Employee Benefit Trust, 988 F.2d 53 (8th Cir. 1993) (holding that trustees of a multi-employer welfare plan may not be held individually liable under ERISA for mismanaging the plan where no loss to the plan is established); Ironworkers Local No. 272 v. Bowen, 695 F.2d 531, 536 (11th Cir. 1983) (finding that although fiduciary breached duty, such breach did not cause loss). See also Cosgrove v. Circle K Corp., 915 F. Supp. 1050, 1066 (D. Ariz. 1995), aff'd, 1997 U.S. App. LEXIS 3853, No. 96-15164, No. 96-16148 (9th Cir. Feb. 27, 1997) (holding no damages against a fiduciary should be imposed under ERISA § 409(a) even if the fiduciary breached his duty where fiduciary caused no loss to the plan and realized no profit).

duties in continuing to hold employer stock in the ESOP in light of the decline in the value of the stock. Relying on the Second Circuit's decision in Diduck v. Kaszycki & Sons Contractors, Inc., 974 F.2d at 279, and then-Judge Scalia's concurring opinion in Fink, 772 F.2d at 962, the Sixth Circuit held that:

> a fiduciary's failure to investigate an investment decision *alone* is not sufficient to show that the decision was not reasonable. Instead, to show that an investment decision breached a fiduciary's duty to act reasonably in an effort to hold the fiduciary liable for a loss attributable to this investment decision, a plaintiff must show a causal link between the failure to investigate and the harm suffered by the plan. In order to establish this causal link, a plaintiff must demonstrate that an adequate investigation would have revealed to a reasonable fiduciary that the investment at issue was improvident.

Kuper, 66 F.3d at 1459-60 (emphasis in original) (citation omitted).

The Sixth Circuit in its opinion below distinguished Kuper on the grounds that "*Kuper* only addressed violations of [ERISA] § 404, not [ERISA] § 406." Chao v. Hall Holding Co., Inc., 285 F.3d at 438 (Pet. App. 41a). It then refused to "read a 'causation' element into a violation of §406" because Congress intended the prohibited transactions enumerated by ERISA § 406(a) to be "per se" violations of ERISA as to which liability for monetary damages may be established in the absence of causation. Id. at 438-439 (Pet. App. 43a-44a).

There is, however, no indication in the express language of ERISA that Congress intended to dilute the basic element of causation in prohibited transaction cases. To the contrary, the plain language of ERISA § 409(a) evidences Congress' intent that the same remedial scheme -- and causation requirement -- apply to all breaches of fiduciary duty, whether that breach results from engaging in a prohibited transaction or some other form of imprudent act. In fact, ERISA § 409(a) on its face applies to all breaches of fiduciary duties, providing that "[a]ny person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good any losses to the plan resulting from such breach . . . ." (Emphasis added.)

Moreover, even if Congress intended to impose different standards of liability on fiduciaries who engage in transactions that are absolutely prohibited by ERISA, there is no indication that it intended to do so with respect to the transactions that are exempted from ERISA § 406(a) if they are deemed to satisfy objective standards of prudence. While certain transactions are absolutely prohibited regardless of their reasonableness, others inherently contain that element because of specific exemptions drafted by Congress. For example, ERISA § 406 prohibits any transaction between a plan and a party in interest, but § 408(b)(2) exempts "reasonable arrangements" for various services. Similarly, ERISA § 408(e) exempts prohibited sales of stock that meet the "good faith" requirements of ERISA § 3(18) such as sales of ESOP stock. In these instances, the courts have held that, while the allegations arise under ERISA § 406, the essential issue was the availability of the exemption and that, in turn, required a determination of reasonableness under ERISA § 404. The Fifth Circuit so held in Donovan v. Cunningham, supra, an

ESOP valuation case, when it instructed that "[t]he statutory reference to good faith in Section 3(18) must be read in light of the overriding duties of Section 404" and that the standard fiduciaries "must follow" in determining fair market value "remains one of prudence." Donovan v. Cunningham, 716 F.2d at 1467, 1473. Outside the ESOP context, the Seventh Circuit in Brock v. Robbins, supra, evaluated a claim that the trustees entered into an unreasonable arrangement for services with a party in interest with reference to ERISA § 404 concepts. The court there stated that "determining whether reasonable compensation was paid under [ERISA §] 406 is 'ultimately the same' analysis as that necessary under [ERISA] section 404 in determining whether the trustees violated the 'prudent person' test of [ERISA] section 404." Brock v. Robbins, 830 F.2d at 644.

We think it makes no sense for the courts to use ERISA § 404 as the primary source of law in a prohibited transaction case, but then ignore the principles of causation that are universally recognized as elements of § 404 claims. We urge the Court to clarify this basic tenet of ERISA jurisprudence in the Sixth Circuit and elsewhere.

II. Certainty is Needed Concerning The Appropriate Approach for Reviewing ESOP Valuations of Closely-Held Employer Stock.

Aside from the important legal issue of causation, the Sixth Circuit's opinion below has created dangerous uncertainty in the area of ESOP jurisprudence. Specifically, the Court should grant Petitioners' writ of *certiorari* to provide definitive guidance to the lower courts on how to adjudicate valuation issues in ESOP cases.

ESOPs valuation issues have been, and continue to be, among the most frequently publicized and litigated both

by private party plaintiffs and by the United States Department of Labor. In fact, a Labor Department representative announced last year that ESOP valuations of closely-held employer stock "are among the top issues being litigated by the Labor Department." See "ESOP Valuations, Contributions Among Top Issues Litigated By DOL," 151 Daily Labor Reprter (BNA) August 7, 2001 at C-2. The Labor Department's website (www.dol.gov/pwba/media) indicates that the Department has in the past several years filed numerous lawsuits relating to ESOP valuations in district courts throughout the country.[5]

In the absence of definitive legislative and regulatory guidance concerning the appropriate standards for evaluating "adequate consideration,"[6] the courts at least since 1983 have

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[5] See, e.g., Herman v. Marine Midland Bank, 99-CV-00605 (W.D.N.Y., filed Aug. 31, 1999; settled July 30, 2002); Chao v. Ruark, et al., 01-CV-02433 (M.D.Pa., filed Dec. 21, 2001); Chao v. Radac Corp., 00-CV-00052, (E.D. Ky., filed March 23, 2000; settled Sept. 10, 2002); Chao v. Dearman, 02-CV-03486 (C.D. Cal., filed Apr. 29, 2002); Chao v. Earle M. Jorgensen Co., 02-CV-00257 (C.D. Cal., filed March 8, 2002).

[6] Beyond the statutory definition of "adequate consideration" in ERISA § 3(18)(B), Congress has offered little, if any, guidance as to how "adequate consideration" is to be evaluated, instead leaving it to the Secretary of Labor to promulgate regulations to clarify the meaning of that term. See ERISA § 3(18)(B) (stating that, in the context of closely-held employer stock, "adequate consideration" means "the fair market value of the asset as determined in good faith by the trustee . . . in accordance with regulations promulgated by the Secretary.") (emphasis added). However, the Secretary of Labor has never issued final regulations, but only has proposed regulations that were published nearly fifteen years ago. See Proposed Regulations of the Department of Labor Defining Adequate Consideration, 53 Fed. Reg. 17632 (May 17, 1988) ("Proposed Regulations"). Cf. Donovan v. Cunningham, 716 F.2d at 1472-1473 (observing that in the absence of final regulations, particular

(continued...)

been guided by the Fifth Circuit's holding in Donovan v. Cunningham, supra, that "[a] court reviewing the adequacy of consideration under Section 3(18) is to ask if the price paid is 'the fair market value of the asset *as determined in good faith by the . . . fiduciary;* it is not to redetermine the appropriate amount for itself *de novo*." Donovan v. Cunningham, 716 F.2d at 1467 (emphasis in original). More recently, the Eighth Circuit affirmed that approach, holding in Mercantile Bank that the critical issue in ESOP cases is not whether ESOP fiduciaries "bought the stock for exactly, to the penny, its fair market value," but rather whether "a prudent fiduciary in [the trustee's] place would have paid what [the trustee] paid." Mercantile Bank, 143 F.3d at 422.

The rulings in Donovan v. Cunningham and Mercantile Bank recognize that ESOP fiduciaries must be accorded some leeway in the area of ESOP valuations. Both decisions recognize, as do valuation professionals generally (including the experts in this case and the DOL in its Proposed Regulations), that valuation of closely-held businesses is an art and not a science and that two valuation professionals would seldom, if ever, reach exactly the same conclusion about the value of stock in a closely-held company. As a practical matter, it is impossible to know for sure what actual "fair market value" is in any particular case. In light of these considerations, the accepted judicial approach to the "adequate consideration" test prior to the Sixth Circuit's opinion below had been that as long as the fiduciary's decision to pay a particular price for employer stock is objectively reasonable -- that is, consistent with what a hypothetical prudent fiduciary would pay under the

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(...continued)

valuation methodologies advanced by the Secretary are entitled to no deference).

circumstances -- the "adequate consideration" test is satisfied and there is no prohibited transaction, no loss to the plan, and no monetary damages may be assessed against the fiduciary even if its investigation was imperfect in some manner.

The Sixth Circuit's rejection of causation as an element of liability and damages in ERISA § 406(a) cases turns this accepted standard on its head, and sanctions a judicial approach to ESOP valuation cases that is inconsistent with the prior case law. In particular, because it rejected the "hypothetical prudent fiduciary standard" in its entirety, the District Court was compelled to do exactly that which the Fifth Circuit in Donovan v. Cunningham said that courts are not supposed to do – its own, de novo valuation of the Hall Holding stock.

The problem with this approach is demonstrated by this case. After days of conflicting expert testimony, with valuations of $ 900,000 to $ 4,000,000 and a dozen points in between, the parties ended up with two de novo judicial valuations – one by the Magistrate Judge, and one by the District Judge, with the District Judge arriving at a price that was exactly $280,713.25 less than that the Magistrate Judge determined to be the "correct" fair market value. As a result, all ESOP fiduciaries in the Sixth Circuit now must select exactly, to the penny, the same "fair market value" as might be determined by the court, or else face personal monetary liability, even if they do not act dishonestly and the transaction is objectively reasonable. The only evidence in the case here concerning causation was that the price paid by the Hall ESOP fiduciaries was well within the range of value that a hypothetical prudent fiduciary would have paid. We urge the Court to confirm that such evidence is not only relevant, but a required element of causation to determine liability and damages in an ESOP case.

Conclusion

For the foregoing reasons, Petitioners respectfully request that the Court issue a writ of *certiorari* in this case.

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APPENDIX

RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 206

ELECTRONIC CITATION: 2002 FED App. 0107P (6th Cir.)
File Name: 02a0107p.06

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ELAINE L. CHAO,
Secretary of the United States
Department of Labor,

Plaintiff-Appellee, *Nos. 99-4142; 00-3041*

v.

HALL HOLDING COMPANY,
INC., DAVID L. GOLDMAN,
KATHLEEN A. KEATING,
GEORGE A. AHEARN,
MICHAEL F. SHIELDS, and
GOLDMAN FINANCIAL
GROUP, INC.,

Defendants-Appellants.

Appeal from the United States District Court
for the Northern District of Ohio at Cleveland.
No. 94-02236-Ann Aldrich, District Judge.

Argued: March 14, 2001

Decided and Filed: April 3, 2002

Before: NORRIS and DAUGHTREY, Circuit Judges; ZATKOFF, Chief District Judge.[1]

COUNSEL

ARGUED: Edward A. Scallet, GROOM LAW GROUP, Washington, D.C., for Appellants. Edward D. Sieger, UNITED STATES DEPARTMENT OF LABOR, OFFICE OF THE SOLICITOR, Washington, D.C., for Appellee. ON BRIEF: Edward A. Scallet, GROOM LAW GROUP, Washington, D.C., Michael J. Frantz, FRANTZ WARD LLP, Cleveland, Ohio, Katherine S. Kamen, LeBOEUF, LAMB, GREENE & MacRAE, Washington, D.C., for Appellants. Edward D. Sieger, Nathaniel I. Spiller, UNITED STATES DEPARTMENT OF LABOR, OFFICE OF THE SOLICITOR, Washington, D.C., for Appellee.

OPINION

LAWRENCE P. ZATKOFF, Chief District Judge. Plaintiff- Appellee Elaine L. Chao,[2] Secretary of the United States Department of Labor, brought this action against Defendants-Appellants, Hall Holding Company, Inc., David L. Goldman, Kathleen A. Keating, George A. Ahearn, Michael F. Shields, and Goldman Financial Group, Inc. In her complaint, the Secretary alleged that various components of an employee stock ownership plan

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[1] The Honorable Lawrence P. Zatkoff, Chief United States District Judge for the Eastern District of Michigan, sitting by designation.

[2] Pursuant to FED. R. Civ. P. 25(d)(1), Secretary Chao has been substituted as a party for Alexis M. Herman.

(hereinafter "ESOP")[3] for the benefit of employees of a subsidiary of Hall Holding Company violated the Employee Retirement Income Security Act (hereinafter "ERISA"), 29 U.S.C. § 1001, *et seq.* Specifically, the Secretary alleged that defendants breached their fiduciary duties by purchasing stock on the ESOP's behalf without adequate investigation and by overpaying for the stock. The district court agreed with the Secretary's position, and granted her motion for summary judgment, finding *inter alia*: (1) defendants, as fiduciaries, failed to conduct a prudent and independent investigation to determine the fair market value of the stock; (2) a showing of harm or loss is not an element of a claim under 29 U.S.C. § 1106(a)(1); and (3) defendants owed the employee stock ownership plan $1,049,549.00, plus interest, which represented the difference between the amount originally paid for the stock and the fair market value of the stock as determined by the district court. For the reasons that follow, we AFFIRM the judgment of the district court.

I. BACKGROUND

A. Substantive Facts

Prior to 1986, defendant Goldman Financial Group, Inc. (hereinafter "defendant GFGI") was a broker that would help business entities buy and sell other businesses. However, in 1986, defendant GFGI began purchasing and holding companies for its own account. As alleged in the Secretary's complaint, the owners of defendant GFGI are

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[3] An ESOP is an employee benefit plan that primarily invests in securities of the employer. *Kuper v. lovenko,* 66 F.3d 1447, 1457 (6th Cir. 1995).

David L. Goldman (hereinafter "defendant Goldman") and a trust benefitting defendant Goldman's children.

In the summer of 1988, defendant GFGI purchased Hall Chemical Company (hereinafter "Hall Chemical") through Hall Holding Company (hereinafter "Hall Holding") for approximately $21 million. Hall Holding is a subsidiary of defendant GFGI and a holding company whose primary asset is Hall Chemical. Defendant Goldman was the sole director of Hall Holding. The president of Hall Chemical was George A. Ahearn (hereinafter "defendant Ahearn") and its Vice-President of Finance and Chief Financial Officer was Michael F. Shields (hereinafter "defendant Shields"). Defendant Ahearn and defendant Shields were also the trustees of the Hall Chemical employee stock ownership plan (hereinafter "Hall Chemical ESOP"). After the acquisition of Hall Chemical, Hall Holding owned 95% of Hall Chemical, and defendant Ahearn had the right to acquire the remaining 5%.

The final defendant is Kathleen A. Keating (hereinafter "defendant Keating"), the Director of Human Resources for defendant GFGI. After the purchase of Hall Chemical, defendant Keating was tasked with analyzing its compensation programs. As a result of her analysis and a meeting with a benefits consulting firm, defendant Keating made a number of recommendations, including the establishment of the Hall Chemical ESOP. Although defendant Goldman did not want to sell any stock, he was eventually persuaded that creation of the Hall Chemical ESOP was a good idea.

In order to set up the Hall Chemical ESOP, defendant Keating retained attorney James Shumaker of Choate, Hall & Stewart in Boston, Massachusetts, whom she described as "very well regarded in the Boston area as

sort of a senior ERISA specialist." Throughout the summer of 1990, defendant Keating and Shumaker spoke on a daily basis about the Hall Chemical ESOP. Shumaker advised defendant Keating that an independent appraisal should be completed by a qualified independent appraiser. Consequently, defendant Keating contacted James Cunningham about the appraisal. Although defendant Ahearn referred to Cunningham as "probably the premiere of analysts, Wall Street analyst of specialty chemical companies," Cunningham had never "perform[ed] a valuation with regard to a subject company where an ESOP was purchasing an interest."

By way of background, Cunningham was employed by The First Boston Corporation. During his employ, he was asked to value defendant GFGI and its various properties, which included Hall Chemical. This was several months prior to the formation of the Hall Chemical ESOP. Cunningham completed this valuation in the spring of 1990. Soon after completing his valuation, Cunningham left The First Boston Company. After leaving, he was again contacted by defendant GFGI about completing a second valuation of Hall Chemical. Cunningham stated that he would complete a second valuation, but that his main priority was to find a job. Cunningham also explained that he would not be willing to inflate his first valuation of Hall Chemical. Finally, Cunningham said that he would consider any new information, but that he did not expect that this would "materially change" the prior valuation. These terms were acceptable to defendant GFGI.

In completing the second valuation, Cunningham explained that he performed a valuation of 100% of Hall Chemical. Although someone may have mentioned something about an ESOP, Cunningham stated that his only job was to value Hall Chemical. Further, Cunningham

stated that if he had been asked to determine "how much an ESOP should pay for. stock in a company," his valuation would have been different. In any event, Cunningham completed his second valuation of Hall Chemical in August 1990. His valuation determined that Hall Chemical was worth between $32.4 and $37.4 million, exclusive of debt, which the district court noted was consistent with his first valuation. *See Reich v. Hall Holding* Co., Inc., 990 F. Supp. 955, 958 (N.D. Ohio 1998).

Upon receiving Cunningham's second valuation, defendant Keating distributed it to several people, including defendant Ahearn, defendant Shields, Shumaker, and other people at defendant GFGI, whom defendant Keating believed to include defendant Goldman. After some discussion with Shumaker, changes were made to the valuation so that it would comply with proposed regulations concerning stock purchases by ESOPs. A finalized version of Cunningham's report was signed and dated September 5, 1990.

At this point, defendant Keating was left to determine a price to pay for the shares to be purchased by the Hall Chemical ESOP. During her deposition, defendant Keating explained how the eventual purchase price of $3.5 million was determined. First, the numbers of the valuation range, $32.4 and $37.4 million, were added and then divided by two. The resultant figure, $34.9 million, was multiplied by the amount of stock to be purchased, which defendant Keating erroneously said was 9.9%.[4] The product of these two numbers was $3.4551 million.

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[4] The actual percentage of stock purchased by the Hall Chemical ESOP was 9.96%. *See infra* notes 6, 7, and 11.

However, instead of using $3.4551 million as the purchase price, it was determined to be $3.5 million. Defendant Keating explained:

> Given these values, I would do exactly the same number today, which is almost directly in the middle except it's a round number, so for purposes of communication, purposes of the documentation, it just would work better at 3.5 million than 3.[4551], which is, after all, you know, you know, .1 percent of the transaction or something that we're talking about here.

When asked who was involved in determining the $3.5 million figure, defendant Keating responded that defendant Goldman and another person at defendant GFGI would have been involved. Defendant Keating was then specifically asked what defendant Goldman's involvement was in the determination of the $3.5 million figure, to which she responded: "He had to be willing to sell the stock at a price."

After the $3.5 million figure was decided upon, it was taken to defendant Goldman for his approval, which was given. The next step was to prepare the Hall Chemical ESOP documents, which were entitled The Hall Chemical Company Employee Stock Participation Plan. Once prepared, these documents provided that Hall Holding was the administrator and named fiduciary. As the sole member of Hall Holding's Board of Directors, defendant Goldman had the authority to appoint individuals to administer the Hall Chemical ESOP and to appoint trustees to invest plan assets. In this capacity, defendant Goldman appointed defendant Ahearn and defendant Shields as members of the committee which served as administrator of the Hall

Chemical ESOP for purposes of ERISA. Further, defendant Ahearn and defendant Shields were appointed trustees of the Hall Chemical ESOP. In this capacity, they secured a loan[5] in the amount of $3.5 million from a Master Trust[6] sponsored by defendant GFGI. The loan amount was used to purchase 9.96%[7] of the stock in Hall Holding, not Hall Chemical, the company valued by Cunningham.

On September 21, 1990, defendant Ahearn and defendant Shields offered to purchase, for the Hall Chemical ESOP, 110 shares, or 9.96%, of Hall Holding stock for $3.5 million. Defendant Goldman accepted the offer, and 110 shares of Hall Holding, not Hall Chemical, were sold to the Hall Chemical ESOP.

B. Procedural History

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[5] The use of a loan to fund an ESOP is referred to as a leveraged ESOP. As the district court explained, an ESOP borrows money to make an initial purchase of stock. Then, an employer contributes money until the debt is retired. *See Hall Holding,* 990 F. Supp. at 957 (citing *Donovan v. Cunningham,* 716 F.2d 1455, 1459 (5th Cir. 1983)). Further, in the present case, the Hall Holding stock was placed in a "suspense account." As the Hall Chemical ESOP made debt payments with the employer contributions, a corresponding amount of stock was released from the suspense account and placed in the Hall Chemical ESOP participant's accounts. *See id.*

[6] As the district court explained, the Master Trust held the assets of other pension plans related to defendant GFGI. *See Hall Holding,* 990 F. Supp. at 958.

[7] The 9.96% figure was reached after defendant Keating consulted with Shumaker. Shumaker opined that a loan from the Master Trust to the Hall Chemical ESOP would not violate ERISA so long as less than 10% of the stock of Hall Chemical was purchased.

On January 9, 1998, the United States District Court for the Northern District of Ohio ruled on the Secretary's motion for partial summary judgment and on defendants' motion for summary judgment and partial summary judgment. In denying both motions, the district court found: (1) defendants' actions were fiduciary decisions subject to ERISA, not sponsor/corporate decisions; (2) defendants' contributions to the Hall Chemical ESOP were not gifts; (3) "defendants,' as the [Hall Chemical] ESOPs fiduciaries, did not conduct a prudent and independent investigation to determine the fair market value of the stock purchased by the [Hall Chemical] ESOP"; and (4) there was a genuine issue of material fact as to whether a reasonable fiduciary would have relied upon Cunningham's valuation in determining the $3.5 million purchase price for the 110 shares of Hall Chemical. *Hall Holding,* 990 F. Supp. at 960, 961, 964, 965.

On March 10, 1998, upon the Secretary's motion for reconsideration, the district court held that "given the factual findings made by this Court in its [January 9, 1998] order, the Secretary is entitled to summary judgment as a matter of law on her claims under ERISA § 406(a)(1)(A) and (D), 29 U.S.C. § 1106(a)(1)(A) and (D)." *Id.* at 965. Specifically, the district court held that no loss needed to be shown in order to establish a violation of these sections of ERISA; failure to conduct a prudent and independent investigation was enough to establish a violation of § 406(a)(1)(A) and (D). *Id.* at 967.

The district court referred the matter to a magistrate judge for a determination of the fair market value of the 110 shares of Hall Holding stock. On December 23, 1998, the magistrate judge issued a report and recommendation after considering the testimony of eight witnesses. The magistrate judge concluded that as of September 28, 1990,

the fair market value of the Hall Holding stock was $2,731,174.75.

On August 10, 1999, the district court accepted the magistrate judge's analysis of the parties expert testimony but rejected his final valuation. Consequently, the district court held that the fair market value of 9.96%[8] of Hall Holding stock on September 28, 1990 was $2,450,451.00.[9] This resulted in damages to the Hall Chemical ESOP of $1,049,549.00, which represented the difference between the amount paid by the Hall Chemical ESOP for the Hall Holding stock and the fair market value of the stock as determined by the district court. *See Reich v. Hall Holding Co., Inc.*, 60 F. Supp. 2d 755, 759, 765 (N.D. Ohio 1999).

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[8] The district court explained that the magistrate judge erroneously used 9.9% instead of 9.96%. *See Reich v. Hall Holding*, 60 F. Supp. 2d 755, 759 (N.D. Ohio 1999).

[9] The district court arrived at its valuation of 9.96% of Hall Holding stock by taking Cunningham's valuation ranges of Hall Chemical under three valuation formulas and subtracting: (1) the $13.6 million debt of Hall Holding; and (2) a 13% minority discount to account for the fact that the Hall Chemical ESOP purchased only a minority interest (9.96%) in Hall Holding. The district court then averaged these three ranges, took the lowest value in the range, and then subtracted: (1) negative accounts receivable and liabilities of Hall Holding; (2) 5% marketability discount to reflect that the market for a closed corporation such as Hall Holding is not as readily available as a market for publicly traded stock; and (3) 5% discount to reflect defendant Ahearn's interest in 5% of Hall Chemical stock. Finally, the district court multiplied the final value of Hall Holding stock by 9.96% to reflect the percentage of Hall Holding stock purchased by the Hall Chemical ESOP and rounded that number up to the nearest dollar. *See Hall Holding*, 60 F. Supp. 2d at 759-64.

On September 28, 1999, the district court, on a motion for reconsideration filed by the Secretary, found that the Hall Chemical ESOP was entitled to $1,188,457.70 in prejudgment interest, which, when added to the initial award of $1,049,549, equaled a total award of $2,238,006.70. Finally, on December 20, 1999, the district court issued an order detailing the method in which the $2,238,006.70 award was to be allocated. Specifically, the allocation was to be based upon the amount of stock that a given participant had received or would receive in the future.

As a result of the proceedings before the district court, defendants filed two notices of appeal in this matter. The first notice of appeal was filed on September 9, 1999 and appealed the district court's orders of January 9, 1998, March 10, 1998, and August 10, 1999. The second notice of appeal was filed by defendants on November 23, 1999. This notice appealed the same orders in the first notice of appeal, in addition to the district court's order of September 28, 1999.

II. STANDARD OF REVIEW

The Court reviews a district court's decision on a motion for summary judgment de novo, using the same legal standards employed by the district court. *See Henderson v. Ardco, Inc.*, 247 F.3d 645, 649 (6th Cir. 2001). Summary judgment is appropriate only if the answers to interrogatories, depositions, admissions, and pleadings combined with the affidavits in support show that no genuine issue as to any material fact remains and the moving party is entitled to judgment as a matter of law. *See* Fed. R. Civ. P. 56(c). A genuine issue of material fact exists when there is "sufficient evidence favoring the nonmoving party for a jury to return a verdict

for that party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986) (citations omitted). In application of this summary judgment standard, the Court must view all materials supplied, including all pleadings, in the light most favorable to the nonmoving party. *See Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). "If the evidence is merely colorable or is not significantly probative, summary judgment may be granted." *Anderson*, 477 U.S. at 249-50 (citations omitted).

The moving party bears the initial responsibility of informing the Court of the basis for its motion and identifying those portions of the record that establish the absence of a genuine issue of material fact. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Once the moving party has met its burden, the nonmoving party must go beyond the pleadings and come forward with specific facts to demonstrate that there is a genuine issue for trial. *See* Fed. R. Civ. P. 56(e); *Celotex*, 477 U.S. at 324. The nonmoving party must do more than show that there is some metaphysical doubt as to the material facts. *See Matsushita*, 475 U.S. at 586. It must present significant probative evidence in support of its opposition to the motion for summary judgment in order to defeat the motion for summary judgment. *See Anderson*, 477 U.S. at 249-50.

III. LEGAL STANDARDS

A. The ERISA Framework

Under ERISA § 406(a), 29 U.S.C. § 1106(a), certain types of transactions between a plan and a party in interest are prohibited. A party in interest is broadly defined to include any fiduciary, a person providing services to the plan, an employer whose employees are covered by the

plan, and certain shareholders and relatives. *See* § 3(14)(A)-(F), 29 U.S.C. § 1002(14)(A)-(F). The prohibited transactions between a plan and a party in interest, as set forth in § 406(a), are as follows:

> Except as provided in section 1108 of this title:
>
> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect-
>
> (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
>
> (B) lending of money or other extension of credit between the plan and a party in interest;
>
> (C) furnishing of goods, services, or facilities between the plan and a party in interest;
>
> (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or
>
> (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

29 U.S.C. § 1106(a). The purpose of § 406(a) is "to prohibit transactions that would clearly injure the plan." *Jordan v. Michigan Conf. of Teamsters Welfare Fund,* 207 F.3d 854, 858 (6th Cir.) (citing *Lockheed Corp. v. Spink,* 517 U.S. 882, 888 (1996)). "Congress adopted § 406 to prevent employee benefit plans from engaging in transactions that would benefit parties in interest at the expense of plan participants and their beneficiaries." Id. (citing *Lockheed Corp.,* 517 U.S. at 888).

Although § 406(a) prohibits transactions between an interested party and a plan, there are exceptions to this rule. Under § 408(e)(1) of ERISA, § 406 does not apply to the acquisition or sale by a plan of the employer's securities as long as the acquisition or sale is for "adequate consideration." 29 U.S.C. § 1108(e)(1). The term "adequate consideration" is defined as follows:

> [I]n the case of an asset other than a security for which there is a generally recognized market the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary.

29 U.S.C. § 1002(18)(B); *see also Herman v. Mercantile Bank, N.A.*, 143 F.3d 419, 421 (8th Cir. 1998). The impetus behind the exception set forth in § 408(e) and other statutory ESOP provisions was Congress's intent "to encourage employees' ownership of their employer company." *Kuper*, 66 F.3d at 1458.

Under ERISA, a plan that primarily invests in the shares of stock of the employer that creates the plan is referred to as an ESOP. *See id.* at 1457. Congress intended ESOPs to function as both "an employee retirement benefit plan and a `technique of corporate finance' that would encourage employee ownership." *Id.* (quoting *Martin v. Feilen*, 965 F.2d 660, 664 (8th Cir. 1992)). "Because of these dual purposes, ESOPs are not designed to guarantee retirement benefits, and they place employee retirement assets at much greater risk than the typical diversified ERISA plan." Id. (citing *Moench v. Robertson, 62* F.3d 553, 568 (3d Cir. 1995) (quoting *Martin*, 965 F.2d at 664)).

Even though ESOPs can be much riskier than a typical ERISA plan, the fiduciaries of these plans are still held to their fiduciary responsibilities, because the statutory exemptions for ESOPs

> do[ ] not relieve a fiduciary . . . from the general fiduciary responsibility provisions of [29 U.S.C. § 1104] which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interests of plan participants and beneficiaries and in a prudent fashion . . . nor does it affect the requirement . . . that a plan must be operated for the exclusive benefit of employees and their beneficiaries.

Kuper, 66 F.3d at 1458 (quoting *Martin*, 965 F.2d at 665 (quoting 44 Fed. Reg. No. 168 at p. 50,369 (Aug. 28, 1979))). Consequently, the duties required of a fiduciary shall be examined.

B. Fiduciary Standards under ERISA

"ERISA is a comprehensive statute designed to promote the interests of employees and their beneficiaries in employee benefit plans." *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 90 (1983). Consequently, ERISA fiduciaries "must act for the exclusive benefit of plan beneficiaries." *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). The fiduciary duties are set forth in ERISA § 404(a)(1), which states:

> . . . [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and-
> (A) for the exclusive purpose of:

> (i) providing benefits to participants and their beneficiaries; and
> (ii) defraying reasonable expenses of administering the plan;
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
> (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
> (D) in accordance with the documents and instruments governing the plan . . . .

29 U.S.C. § 1104(a)(1). In *Kuper,* another panel of this court explained that the fiduciary duties enumerated under § 404(a)(1) had "three components":

> The first is a "duty of loyalty" pursuant to which "all decisions regarding an ERISA plan `must be made with an eye single to the interests of the participants and beneficiaries.'" *Berlin v. Michigan Bell Tele.* Co., 858 F.2d 1154, 1162 (6th Cir. 1988) (quoting *Donovan v. Bierwirth,* 680 F.2d 263, 271 (2d Cir.), *cert. denied,* 459 U.S. 1069, 103 S. Ct. 488, 74 L. Ed.2d 631 (1982)). The second obligation imposed under ERISA, the "prudent man" obligation, imposes "an unwavering duty" to act both "as a prudent person would act in a similar situation" and "with single-minded devotion" to those same plan participants

> and beneficiaries. Id. Finally, an ERISA fiduciary must "'act for the exclusive purpose'" of providing benefits to plan beneficiaries. Id. (quoting *[Bierwirth], 680* F.2d at 271).

Kuper, 66 F.3d at 1458.

Clearly, the duties charged to an ERISA fiduciary are "the highest known to the law." *Howard,* 100 F.3d at 1488 (quoting *Bierwirth,* 680 F.2d at 272 n.8); *see also Moench,* 62 F.3d at 560 (describing a fiduciary's obligations as "strict" and "detailed"). When enforcing these duties, "the court focuses not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction." *Howard,* 100 F.3d at 1488 (citing *Donovan v. Cunningham,* 716 F.2d 1455, 1467 (5th Cir. 1983); *Donovan v. Mazzola,* 716 F.2d 1226, 1233 (9th Cir.1983)). Failure to meet these high standards may result in personal liability for the fiduciary. *See* 29 U.S.C. § 1109(a); *see also Kuper,* 66 F.3d at 1458.

IV. ANALYSIS

The Court will now turn to the claims of error raised by. defendants on appeal. A review of defendants' brief demonstrates that they have three claims of error on appeal, in addition to another matter that was raised in a footnote. The Court will first examine the matter raised by defendants in a footnote, which concerns whether defendant GFGI is a party to this case and whether other defendants are fiduciaries. The Court will then examine defendants' three remaining claims, which are: (1) whether there was a genuine issue of material fact to preclude summary judgment; (2) whether the district court erred in refusing to consider what a reasonable hypothetical fiduciary would

have paid for the stock and whether there is a causation element for claims under ERISA § 406(a)(1), 29 U.S.C. § 406(a)(1); and (3) whether the district court's award to the Hall Chemical ESOP participants was proper. As the following discussion will show, defendants cannot prevail on any of their claims.

A. Defendants' Claims as to Defendant GFGI and Defendants' Fiduciary Status

As an initial matter, the Court will address an issue that could possibly be dispositive as to some defendants. This issue, raised by defendants in a footnote, contends that not all defendants are fiduciaries and that no allegations were made against defendant GFGI. The Court will address each claim in turn.

1. Defendant GFGI

Defendants first argue that as to defendant GFGI, the Secretary "made no allegations and sought no relief against defendant GFGI in the count of the complaint dealing with the ESOP purchase of stock: the only mention of defendant GFGI is in count two of the complaint which was voluntarily dismissed by the [Secretary]." The Secretary responds to this argument by noting that it is raised for the first time on appeal. However, the Secretary does acknowledge this "pleading omission."

Generally, "[t]his court will not decide issues or claims not litigated before the district court." *White v. Anchor Motor Freight, Inc.*, 899 F.2d 555, 559 (6th Cir. 1990) (citing *Boddie v. Am. Broad. Cos.*, Inc., 881 F.2d 267, 268 n. 1 (6th Cir. 1989); *Yeiter v. Secretary Health and Human Servs.*, 818 F.2d 8, 11 (6th Cir. 1987)). "[W]e review the case presented to the district court rather than a

better case fashioned after the district court's order." *White,* 899 F.2d at 559 (quoting *Adams v. James,* 784 F.2d 1077, 1080 (11th Cir. 1986)). However, "[w]e have, on occasion, deviated from the general rule in `exceptional cases or particular circumstances' or when the rule would produce `a plain miscarriage of justice.'" *Foster v. Barilow,* 6 F.3d 405, 407 (6th Cir. 1993) (internal quotations omitted) (quoting *Pinney Dock and Transport Co. v. Penn Central Corp.,* 838 F.2d 1445, 1461 (6th Cir. 1988) (citation omitted) (quoting *Hormel v. Helvering,* 312 U.S. 552, 557, 558 (1941))); *see also Singleton v. Wulff,* 428 U.S. 106, 121 (1976). Although there are exceptions to this general rule, they are narrow. *See Foster,* 6 F.3d at 407. The Court has discretion to resolve an issue that was not raised before the district court "where the proper resolution is beyond any doubt, or where injustice might otherwise result." *Enertech Elec., Inc. v. Mahoning County Comm'rs,* 85 F.3d 257, 261 (6th Cir. 1996) (citing *Brown v. Crowe,* 963 F.2d 895, 897-98 (6th Cir. 1992); *Newmyer v. Philatelic Leasing, Ltd.,* 888 F.2d 385, 387 (6th Cir.1989)).

After reviewing the arguments presented in the briefs, as well as the record below, the Court finds no reason to address this issue which has been raised for the first time on appeal. As to the issue of whether injustice might result, in *Smith v. CMTA-IAM Pension Trust,* 654 F.2d 650 (9th Cir. 1981), the Ninth Circuit was presented with a situation similar to the present case. In *Smith,* the parties conducted themselves before the district court as though there were an ERISA claim as well as another state law claim. *See id.* at 654 n.2. However, these claims were never presented to the district court. *See id.* Consequently, the "Appellees argue[d] that the ERISA claim [could not] be raised . . . because it was not properly before the district court." *See id.* The Ninth Circuit disagreed, stating:

> Although [the] complaint was never technically amended to include either the ERISA or the state claim, both were fully argued in the parties' pre-hearing memoranda as well as at the motions hearing. While we do not approve of appellant's failure to adhere strictly to the procedures for amendment mandated by Fed. R. Civ. P.15(a), where both parties have fully argued a claim below, we will treat the pleadings as though they have been amended for purposes of appellate review. *See Riley v. MESA Pension Trust,* 570 F.2d 406, 408 (2d Cir. 1977); *Sherman v. Hallbauer,* 455 F.2d 1236, 1242 (5th Cir. 1972); *Bobrick Corp. v. American Dispenser Co., Inc.,* 377 F.2d 334, 337 (9th Cir. 1967); *Aluminum Co. of America v. Admiral Merch. Motor Freight, Inc.*, 337 F. Supp. 674, 683-84 (N.D. Ill. 1972), *affirmed,* 486 F.2d 717 [(7th Cir.)], *cert. denied,* 414 U.S. 1113, 94 S. Ct. 843, 38 L. Ed.2d 739 [1973].

Smith, 654 F.2d at 654 n.2.

In the present case, no injustice will result because, as in *Smith,* all parties conducted themselves before the district court as though defendant GFGI were a party to this case. First and foremost, defendant GFGI was named in the caption at all stages before the district court. Second, the Secretary's motion for summary judgment and her reply brief treat defendant GFGI as though it is a party, referring collectively to "the defendants." Third, defendants' responsive brief also refers to themselves collectively as

defendants. Fourth, the district court's various opinions contemplate that each defendant is a party to the case, as they also refer to "the defendants" collectively. Consequently, because all parties acted as though defendant GFGI was a party, and in such instances other courts have treated the complaint as though it had been amended, *see id.*, the Court finds that no injustice will result from treating defendant GFGI as any other defendant in the present case.

Further, the Court finds the resolution of the issue of whether defendant GFGI is a defendant is not in doubt. Other courts have allowed pleadings to be amended at a very late stage in similar circumstances. *See id.* Therefore, it is quite possible that the Secretary's complaint could be amended at this late stage. Consequently, the Court declines to address the issue of whether defendant GFGI is a proper party in this case because no injustice will result and resolution of the matter would most probably not be in defendant's favor.

2. Defendants' Fiduciary Status

Defendants also contend that they are not all fiduciaries. With no citation to authority, defendants argue that defendant Hall Holding and defendant Goldman

> were alleged to be fiduciaries solely because they appointed the ESOP trustees, but there is no allegation, and [the Secretary] offered no evidence, that appointing Messrs. Ahearn and Shields was somehow a breach of fiduciary duty or had anything to do with the price paid for the stock.

Defendants also argue that the district court erroneously "assumed" that [defendant] Keating was a fiduciary, which

is a complete mischaracterization of the proceedings before the district court. In its opinion, the district court explained its determination as to the issue of defendants' fiduciary status:

> The only argument the defendants make to contest the Secretary's position that each defendant is a fiduciary under ERISA is that the actions and decisions of the defendants surrounding the stock purchase were corporate or sponsor actions not subject to ERISA's fiduciary standards. As discussed above, this argument is rejected. The defendants have not otherwise challenged the Secretary's characterization of them as fiduciaries. In fact, the defendants explicitly state that if the Court does reject their sponsor/fiduciary distinction argument, they "are not afraid to argue this case on the Secretary's theory. . . ." Therefore, in light of the defendants' position and this Court's own legal opinion that the defendants were indeed fiduciaries, the Court holds that the defendants were Hall [Chemical ESOP] fiduciaries during the time in question.

Reich v. Hall Holding Co., 990 F. Supp. 955, 963 n.9 (N.D. Ohio 1998).

It is clear from the district court's opinion that defendants considered the issue of whether they were fiduciaries. Defendants chose to contest their fiduciary status only by arguing that the decisions made concerning the purchase of Hall Holding stock were corporate decisions, not fiduciary decisions. Defendants cannot now hope to argue that they were not fiduciaries at all, because the Court only reviews "the case presented to the district

court rather than a better case fashioned after the district court's order." *White*, 899 F.2d at 559 (quoting *Adams, 784* F.2d at 1080). Consequently, because this issue was not raised before the district court, this Court will not review it for the first time on appeal.

B. Defendants' First Claim of Error

Defendants' first claim on appeal is that the district court erred in granting summary judgment because there was a genuine issue of material fact as to whether defendants complied with their fiduciary duties. In conjunction with this argument, defendants raise seven different sets of facts[10] which they claim demonstrate that a genuine issue of

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[10] Defendants state that the magistrate judge found there is "much evidence" to show that a genuine issue of material fact existed. The phrase "much evidence" is quoted from the magistrate judge's report and recommended decision, in which he states as follows:

> Defendants offered much *evidence* and submitted legal authority which essentially seeks to reargue the liability finding of this court. In an abundance of caution, the evidence was admitted for whatever value it might have on the fair market value issue. After consideration, that evidence is of little or no relevance. The liability issue is beyond the scope of the reference.

(Emphasis added). Defendants' statement that the magistrate judge found "there is `much evidence' in the record raising genuine issues of material fact in this case" is a mischaracterization of the magistrate judge's statement. The magistrate judge simply stated that defendants *presented* "much evidence." He did not find that there was a genuine issue of material fact, nor did he make any determinations as to the effect or persuasiveness of this evidence at the summary judgment stage. In fact, the magistrate judge concluded that the "much evidence" submitted by defendants was simply of little or no relevance to the issues before him.

material fact existed. However, after reviewing the record, the Court finds that the district court properly granted the Secretary's motion for summary judgment.

1. Defendants' Reliance on Cunningham's Valuation

In an attempt to demonstrate a genuine issue of material fact, defendants first point to Cunningham's valuation. The most troubling aspect of defendants' argument concerning the valuation is their statement that "defendants made sure that Mr. Cunningham had access to all of the information he needed to prepare the valuation." Simply put, this is not true. A review of Cunningham's deposition testimony reveals that he was not fully informed of all circumstances when he completed his valuation of Hall Chemical. Cunningham testified that he was asked by an official at defendant GFGI to do a valuation of Hall Chemical and that he was unaware that the purpose of the valuation "was to establish a value to have an ESOP buy a stake in Hall Chemical." Cunningham also testified that the official at defendant GFGI may have said something about an ESOP, but this "wouldn't have changed how I did the valuation." Asked why this would not have changed the valuation, Cunningham explained that he was not asked to consider the Hall Chemical ESOP. He stated that he "was asked to value Hall Chemical Company. That's all I was asked to do." After this testimony, the following exchange took place between counsel for the Secretary and Cunningham:

Q. So let's say that I come in and charge you with the following. I want you to conduct a valuation that will tell me how much an ESOP should pay for stock in a company that it wants to buy. Would your valuation be different?

A. Well, you've asked me a different question.
Q. That's right. Would the valuation be different?
A. Yes. I would have done a second - probably a second - I would have been forced, had I been willing to take on that assignment, I would have been forced to do a second stage, if you will, valuation.
Q. And what would that have entailed?
A. That would have involved what - if Hall Chemical Company is worth X and the ESOP is going to buy some percentage of X, that would have involved what is a minority stake in a privately held company worth.
Q. And you're saying that you didn't conduct such a valuation because you weren't asked to?
A. No, I was not asked, to. I didn't do it.

In *Howard v. Shay*, 100 F.3d 1484 (9th Cir. 1996), the Ninth Circuit discussed the use of and reliance upon financial advisors and legal counsel. "Although securing an independent assessment from a financial advisor or legal counsel is evidence of a thorough investigation, *Martin v. Feilen*, 965 F.2d 660, 670-71 (8th Cir.1992), it is not a complete defense to a charge of imprudence." *Howard*, 100 F.3d at 1489 (citing *Donovan v. Mazzola*, 716 F.2d 1226, 1234 (9th Cir. 1983)). Further, "independent expert advice is not a `whitewash.'" *Id.* (citing *Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cir. 1982); *Donovan v. Walton*, 609 F. Supp. 1221, 1.227 n.10 (S.D. Fla. 1985); *Cator v. Herrgott & Wilson, Inc.*, 609 F. Supp. 12, 16 (N.D. Cal. 1984)). Consequently, the Ninth Circuit promulgated three requirements, which this Court adopts, for a fiduciary of an ESOP when relying upon expert advice:

> The fiduciary must (1) investigate the expert's qualifications . . . (2) provide the expert with complete and accurate information . . . and (3) make certain that reliance on the expert's advice is reasonably justified under the circumstances.

Howard, 100 F.3d at 1489.

In the present case, the parties do not dispute Cunningham's qualifications to value Hall Chemical. The concern with the valuation comes under the second and third requirements. As to the second requirement, it is clear that Cunningham was not provided with complete and accurate information. His own testimony established that his only job was to valuate Hall Chemical. Cunningham testified that something may have been mentioned about an ESOP, but that, as explained to him, this had no effect on his task of valuating Hall Chemical. Basically, Cunningham was never given the true purpose for which his valuation was to be used. Had Cunningham been given full information, he testified that he would have done a different valuation. In addition to these concerns, Cunningham's valuation did not take into account defendant Ahearn's rights to acquire 5% of Hall Chemical and, as defendant Shields testified, the net liability number that Cunningham used in the valuation failed to account for somewhere between $400,000.00 and $500,000.00.

As to the third requirement, the Court finds that it also has not been satisfied. Reliance upon Cunningham's valuation was not justified under the circumstances present in this case. Cunningham valued Hall Chemical, not Hall Holding. However, Cunningham's valuation of Hall Chemical was used to establish Hall Holding's value. Although it is true that Hall Chemical was the major asset

of Hall Holding, the fact remains that Hall Chemical and Hall Holding are two different entities. Therefore, if defendants wished to sell the stock of Hall Holding, then they should have had that company appraised, not Hall Chemical.

In sum, defendants' reliance upon Cunningham's valuation is not a defense in this case. As the previous discussion demonstrated, Cunningham was not provided with complete and accurate information.[11] Further, defendants' reliance on Cunningham's valuation of Hall Chemical in determining Hall Holding's value was not reasonably justified. Instead, defendants' reliance on his valuation was a breach of defendants' fiduciary duties under § 404(a)(1). Specifically, defendants breached the "prudent man" obligation, which the court in *Kuper* explained was one of the duties under § 404(a)(1). In determining the value of the 110 shares of Hall Holding

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[11] As discussed above, in their brief on appeal, defendants raise several sets of facts which they claim demonstrate a genuine issue of material fact. Defendants submit that because they reviewed Cunningham's draft valuation, discussed it with outside ERISA counsel, recommended changes to the draft valuation, and reviewed and discussed the final valuation among themselves and with outside ERISA counsel, there is a genuine issue of material fact as to whether they conducted a prudent and independent investigation. However, the Court finds that none of the above-listed facts are relevant to this determination. Because Cunningham's valuation was tainted by the fact that he did not have all of the information he needed, and because the valuation of Hall Chemical was improperly applied to Hall Holding, it did not matter that defendants spent a great deal of time reviewing and recommending changes to Cunningham's valuation. Defendants cannot claim as a defense to this action that a great deal of time was spent reviewing and changing a valuation which was flawed from its inception and performed on the wrong company.

stock, defendants did not act "as a prudent person would act in a similar situation," nor did they act with a "single-minded devotion" to the Hall Chemical ESOP participants. Rather, defendants failed to give Cunningham the information he needed to make a proper valuation, and, without input from any expert, including Cunningham, they assumed that the valuation of Hall Chemical was the same as a valuation of Hall Holding. Consequently, the Court finds these problems alone are enough to affirm the district court's holding. There is no genuine issue of material fact in this case; a violation of 29 U.S.C. § 1106(a)(1) occurred.

2. Other Concerns with Defendants' Determination of the Purchase Price for the Hall Holding Stock

In addition to the issues surrounding Cunningham's valuation, the Court would note several other concerns with the process of determining the price for the 110 shares of Hall Holding stock. First, even though defendant Ahearn and defendant Shields were the trustees of the Hall Chemical ESOP, they had very little to do with the major decisions that concerned it. During his deposition, defendant Ahearn testified that he never consulted with legal counsel concerning the setup of the Hall Chemical ESOP and that he went to one meeting with Shumaker at which defendant Keating and defendant Shields were present. Further, defendant Ahearn also had no input on the price that was to be paid by the Hall Chemical ESOP for the purchase of the Hall Holding shares. Defendant Ahearn testified that he was told that the value for Hall Holding was the midpoint of Cunningham's valuation of Hall Chemical, which was approximately $35 million. Eventually, the $3.5 million purchase price was derived from this midpoint figure; however, defendant Ahearn had no input on these decisions, nor was he aware of how the values were determined.

Defendant Shields testimony is very similar to defendant Ahearn's in that he also had very little input on the Hall Chemical ESOP's purchase of the stock, even though he was a trustee. Initially, defendant Shields testified that the Hall Chemical ESOP was originally going to purchase stock in Hall Chemical. At some later date, the decision was made to purchase stock in Hall Holding instead. Defendant Shields testified that defendant Keating made the decision to purchase stock in Hall Holding and that he did not help make that decision. In addition, Article 11.4 of the Hall Chemical Company Employee Stock Participation Plan requires that "[t]he company shall notify the Trustee of the identity of the Administrator . . . ." However, defendant Shields testified that as to his recollection, he did not remember an administrator being appointed.

As to Cunningham's valuation, defendant Shields testified that he never consulted with Cunningham, had no input into the decision to hire Cunningham, nor did he know what documents Cunningham reviewed in preparation of the valuation. Further, defendant Shields did not know if defendant Ahearn had any input into the decision to hire Cunningham. Defendant Shields believed that defendant Keating was the person that made the arrangements to conduct the valuation. Finally, the following exchange took place between defendant Shields and one of the Secretary's attorneys:

Q. . . . How was it decided that the ESOP would purchase $3.5 million worth of shares? How did we arrive at that number?
A. I have no idea.
Q. You're the trustee of the ESOP, correct?
A. Uh-huh.

Q. Or at least at that time you were?
A. Uh-huh.
Q. And you don't know how the 3.5 million was arrived at?
A. I wasn't the owner. I would expect the owner decides how much of the company he's willing to sell.

In Howard, the Ninth Circuit was troubled by the fact that "[t]he fiduciaries completed the transaction without negotiation." *Howard*, 100 F.3d at 1489. In the present case, not only did the fiduciaries completely fail to negotiate as to the purchase price for the Hall Holding stock, but they were generally unaware of who determined the purchase price.

In addition to the concerns raised by defendant Ahearn and defendant Shields, the deposition testimony of defendant Keating is even more disturbing. First, defendant Keating testified regarding the loan from the Master Trust to fund the purchase of Hall Holdings shares. The following exchange took place during defendant Keating's testimony:

Q. . . . At the time you were considering the ESOPs, loaning, borrowing money to make this purchase, did you have a, a particular interest rate in mind?
A. From the ESOP standpoint, or from the Master Trust standpoint?
Q. From the ESOP standpoint.
A. I was more concerned from the Master Trust standpoint, so no. I wanted to get a rate that was favorable to the Master Trust.

Defendant Keating also testified that after receiving Cunningham's draft valuation report, she reviewed it and

solicited input from defendant Ahearn and Shumaker. However, she specifically stated that she "most probably" did not speak with the other trustee, defendant Shields, about the draft valuation.

The most disturbing part of defendant Keating's testimony concerned the determination of the price to pay for the Hall Holding stock. Defendant Keating testified that besides herself, defendant Goldman and maybe one other person was involved in determining the price. However, neither defendant Ahearn nor defendant Shields, the two trustees, were involved in setting the price. Finally, defendant Keating's testimony as to how she reached the price of $3.5 million is extremely disconcerting. This testimony was set forth in the background section, but it bears repeating here. She testified that the high and low end of Cunningham's valuation range, $32.4 and $37.4 million, were added and divided by two, and the resultant figure, 34.9, was multiplied by the amount of stock to be purchased, which defendant Keating erroneously said was 9.9%. The product of these two numbers was 3.4551. However, instead of taking $3.4551 million as the purchase price, the amount was determined to be $3.5 million. Defendant Keating explained:

> Given these values, I would do exactly the same number today, which is almost directly in the middle except it's a round number, so for purposes of communication, purposes of the documentation, it just would work better at 3.5 million than 3.[4551], which is, after all, you know, you know, .1 percent of the transaction or something that we're talking about here.

Essentially, defendant Keating's testimony demonstrates that she was willing to charge the Hall Chemical ESOP an extra $44,900.00, the difference between the actual $3.5 million purchase price and $3,445,100.00, "for purposes of communication."[12]

Again, the Court has held that the above-discussed issues with Cunningham's valuation alone are enough to affirm the district court's holding that a violation of 29 U.S.C. § 1106(a)(1) occurred. Nonetheless, the preceding discussion was intended to show the numerous concerns with the creation of the Hall Chemical ESOP. Essentially, the facts demonstrate that the Hall Chemical ESOP was established in an environment where the trustees were unaware of what was going on, the trustees were not consulted on major decisions affecting the Hall Chemical ESOP, there was no negotiation as to the price of the Hall Holding stock, there was more concern for the return on investment for the Master Trust, and the inconvenience of dealing with uneven numbers could justify charging the Hall Chemical ESOP an additional $44,900.00 for the stock it purchased. Such facts demonstrate not only the uniquely careless and haphazard manner in which the Hall Chemical ESOP was created, but also clear violations of defendants' fiduciary duties.

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[12] The Court acknowledges that defendant Keating did not use the proper percentage in her calculations. Defendant Keating used 9.9% to represent the amount of stock that the Hall Chemical ESOP would purchase from Hall Holding. However, the Hall Chemical ESOP purchased 9.96% of Hall Holding's stock. Nonetheless, the Hall Chemical ESOP was overcharged by $23,960.00 so that defendants could deal with round numbers. The $23,960.00 figure is determined by multiplying $34.9 million by 9.96%, and then subtracting the product from $3.5 million.

In fact, reviewing the discussion in *Kuper* of a fiduciary's duties under § 404(a)(1), it is clear that each of the three duties was breached by at least one defendant in this matter. *See Kuper, 66* F.3d at 1458. Defendant Keating's testimony that she was more concerned about getting an interest rate favorable to the Master Trust, and the failure of defendant Ahearn or defendant Shields to question this, demonstrate that the duty of loyalty was breached. None of these three defendants acted with an "eye single to the interests" of the Hall Chemical ESOP participants. As to the "prudent man" standard, the trustee's utter failure to be involved in the price charged for the Hall Holding stock demonstrates that this duty was breached. Further, it is difficult to believe that any prudent person would use the valuation of a different company and rely on it when not all relevant information was given to the expert conducting the valuation. Finally, the fiduciaries did not "act for the exclusive purpose" of providing benefits to the Hall Chemical ESOP participants. Instead, the purchase price was rounded up so it was easier to communicate, and the trustees were unaware that any of this was taking place. The decisions were simply made with no input from the people that a had a fiduciary duty to be involved in the decisions. These breaches of fiduciary duty simply reinforce this Court's finding that the district court was correct in granting the Secretary's motion for summary judgment as there are no genuine issues of material fact.

C. Defendants' Second Claim of Error

Defendants' next claim of error on appeal is that the district court erred in not finding what a hypothetical reasonable fiduciary would have paid for the 110 shares of Hall Holding stock. Essentially, defendants argue that if a hypothetical reasonable fiduciary would have paid the same price for the shares as the Hall Chemical ESOP did,

then defendants cannot be liable. However, as the following discussion will show, a violation of § 406 is a per se violation, notwithstanding the price a reasonable hypothetical fiduciary would have paid for the stock.

1 . Herman v. Mercantile Bank, N.A.

In their brief on appeal, defendants rely on *Herman v. Mercantile Bank, N.A.*, 143 F.3d 419 (8th Cir. 1998), in support of their position that the district court erred when it did not make a determination as to the price a reasonable hypothetical fiduciary would have paid. In *Mercantile Bank*, a closely held corporation called Lenco established an ESOP under which its employees owned stock. Mercantile Bank was the ESOP's trustee, and on April 5, 1984, sold the ESOP's stock to a person named Jerry Ford. Apparently, Ford engaged in several transactions which resulted in him owning all of Lenco's stock. On that same day, Mercantile Bank was replaced as the ESOP's trustee by Paul Mueller. The day after these transactions took place, Mueller had the ESOP repurchase the stock from Ford at the same price it had sold the stock on the prior day. In 1985, Mueller passed away, and Mercantile Bank again took over as trustee of the ESOP. Over the next few years, Lenco began to experience financial problems which culminated in filing for bankruptcy on June 20, 1989. Id. at 421. In addition to these facts, the dissenting opinion had the following to add:

> Before the ESOP sold its stock to Ford, the ESOP owned 33.3% of the outstanding stock. The next day, when the ESOP bought back the stock for the same price per share, it owned 63.2% of the outstanding stock because Lenco had used most of the proceeds of the [bank] loan to Lenco to

> redeem 230,826 of its previously outstanding shares mostly held by Ford. Even though the ESOP now owned a greater stake in Lenco, Lenco now had extraordinary debt, restrictions on its cash flow as a condition of [a bank] loan, and greatly reduced equity. Before the leveraged buyout, Lenco's total liabilities equaled $1,917,442.00. After the buyout, Lenco's total liabilities tripled to an amount exceeding six million dollars. Before the buyout, Lenco reported an equity (book) value of $5.4 million. The [bank] loan of $5.25 million almost wiped out this equity. Ford added no assets or other equity as part of the buyout. Thus, Lenco went from a substantial business with over five million dollars in equity to a corporation with great debt and practically no equity.

Id. at 424 (Bright, J., dissenting) (footnotes omitted). In addition, Mercantile Bank was also the trustee over two testamentary trusts that had been established by the deceased owner of Lenco. The primary asset of these trusts was the majority of voting stock in Lenco. The same person at Mercantile Bank, Jack Niemeyer, was the representative for the ESOP and the trusts on Lenco's board of directors. *Id.* at 423.

Further, the dissent touched upon the minimal amount of investigation undertaken by Mercantile Bank. Although Mercantile Bank conducted a valuation of Lenco prior to the sale and buy-back, it knew little about Ford's financing plans:

> Ford provided Mercantile with a copy of a two paragraph, preliminary commitment letter from his financing bank. . . . The letter neglected to identify any terms of the loan, its amount, its borrowing formula, or the interest rate. Mercantile did nothing further to verify the financial feasibility of Ford's takeover of Lenco.

Id. at 424 (footnote omitted). Finally, Mercantile made no investigation as to its replacement, Mueller, or his intentions. *Id.*

After noting that an ESOP may only purchase an employer's stock for adequate consideration, the Eighth Circuit held:

> Even if a trustee fails to make a good faith effort to determine the fair market value of the stock, "he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway." *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994). Thus, if a prudent trustee would have purchased the Lenco stock for the price for which Mueller purchased it, then Mueller did not violate ERISA, regardless of whether he made a good faith effort to determine the fair market value of the stock.

Id. at 421. The Eight Circuit then reviewed the evidence presented at trial. The expert witness for each side presented vastly different values for Lenco. The district court concluded that each expert was credible, and that even if Mueller did overpay, it was only slightly and

Mueller had no reason to know the ESOP overpaid for Lenco's stock. The Eight Circuit concluded that "[t]his amounts to a finding that a hypothetical prudent fiduciary in Mueller's place could have and would have paid what Mueller paid for the stock" and therefore ERISA was not violated. *Id.* at 421-22.

Obviously, the dissent disagreed with majority's conclusion. After discussing the high fiduciary standards to which trustees of ESOPs are held, the dissent examined the "adequate consideration" exception to § 406(a)(1)(A) and (D) and the definition of that term:

> ERISA §§. 406(a)(1)(A) and (D), 29 U.S.C. §§ 1106(a)(1)(A) and (D), prohibit a plan from buying or selling securities issued by the plan's employer sponsor because such transactions carry an inherent risk of "self-dealing" and "conflicts of interest." However, Congress created § 408(e) of ERISA, 29 U.S.C. § 1108(e), to provide a narrow exemption to the § 406(a) prohibition. Section 408(e) permits employee benefit plans to purchase or sell employer securities only if the sale or purchase of the securities is for adequate consideration. *The definition of "adequate consideration" under ERISA imposes a two fold requirement: (1) the price paid must reflect the fair market value of the asset, and (2) the trustee must conduct a careful and independent investigation of the circumstances prevailing at the time of the investment. Donovan v. Cunningham*, 716 F.2d 1455, 1467-68 (5th Cir.1983).

Id. at 425 (Bright, J., dissenting) (emphasis added). The dissent concluded that Mercantile Bank violated its duties in three separate ways: (1) by failing to conduct an independent investigation of the transactions at issue and Ford; (2) "by failing to investigate whether the details of the sale transaction would advantage the ESOP employee beneficiaries"; and (3) *by* failing to correct its past failures when it resumed its position as trustee after Ford's death. *Id.*

After reviewing both positions, the Court finds that the position announced in the dissenting opinion in *Mercantile Bank* is much more persuasive. Were the Court to adopt the position espoused by defendants and the majority in *Mercantile Bank,* the Court would be required to ignore a portion of the definition of "adequate consideration." The Court believes such an interpretation is improper and contrary to Congress's intent.

ERISA § 406(a)(1) prohibits transactions in which an employee benefit plan purchases stock from the employer. 29 U.S.C. § 1106(a)(1). However, the exception to this rule is found in § 408(e), which states that § 406(a)(1) shall not apply if the purchase is for "adequate consideration." 29 U.S.C. § 1108(e). ERISA § 3(18)(B) defines "adequate consideration" in the closely held corporation situation as "the fair market value of the asset as determined in good faith by the trustee. . . ." 29 U.S.C. § 1002(18)(B). As explained by the dissent in *Mercantile Bank,* the definition of "adequate consideration" has two distinct parts. First, there is the "fair market value" part, then there is the "as determined in good faith by the trustee" part. 29 U.S.C. § 1002(18)(B). However, the majority opinion in *Mercantile Bank* gives no weight to the good faith determination under § 3(18)(B). *See* 29 U.S.C. § 1002(18)(B).

In *Donovan v. Cunningham*, 716 F.2d 1455 (5th Cir. 1983), the Fifth Circuit stated that "[t]he focus of the inquiry is how the fiduciary acted in his selection of the investment, and not whether his investments succeeded or failed." *Id.* at 1467 (quoting 19B S. Young, BUSINESS ORGANIZATIONS, § 17.02[3]). The Fifth Circuit then explained that when determining whether "adequate consideration" has been paid, it is not enough that a fiduciary, by chance, arrived at fair market value:

> ERISA's requirement that ESOP fiduciaries purchase employer stock for "adequate consideration" must be interpreted so as to give effect to the Section 404 duties to which those persons remain subject. In this regard, it is especially significant that the adequate consideration test, like the prudent man rule, is expressly focused upon the *conduct of* the fiduciaries. A court reviewing the adequacy of consideration under Section 3(18) is to ask if the price paid is "the fair market value of the asset *as determined in good faith by the . . . fiduciary,"* it is not to redetermine the appropriate amount for itself *de novo.* Contrary to the appellees' contentions, this is not a search for subjective good faith--a pure heart and an empty head are not enough. The statutory reference to good faith in Section 3(18) must be read in light of the overriding duties of Section 404. Doing so, we hold that the ESOP fiduciaries will carry their burden to prove that adequate consideration was paid by showing that they arrived at their

> determination of fair market value by way of a prudent investigation in the circumstances then prevailing.

Id. at 1467-68 (emphasis in original) (footnotes omitted); *see also Reich v. Valley Nat. Bank of Arizona*, 837 F. Supp. 1259, 1280-81 (S.D.N.Y. 1993).

Returning to the present case, the Court finds that the district court did not err in failing to determine whether a hypothetical reasonable fiduciary would have purchased the Hall Holding stock at the same price. When determining "adequate consideration," § 3(18)(B) requires not only a determination of fair market value, but also an examination of the process that led to the determination of fair market value in light of § 404's fiduciary duties. As the discussion in the prior section demonstrated, defendants did not make a good faith determination as to the price of the Hall Holding stock. This lack of good faith is demonstrated by the following: (1) Defendants' reliance on Cunningham's valuation was improper because Cunningham was not given all of the information he needed to complete the valuation and because he valued the wrong company; (2) the trustees were generally unaware of what was going on; (3) the trustees were not consulted on major decisions, such as the price to pay for Hall Holding stock; (4) there was no negotiation as to the price of the Hall Holding stock; (5) there was more concern for the return on investment for the Master Trust; and (6) the Hall Chemical ESOP was charged several thousand dollars more so that defendants could deal in round numbers.

These facts clearly demonstrate that defendants engaged in a prohibited transaction. Because defendants did not engage in a good faith determination of the fair market value of Hall Holding stock, the definition of "adequate

consideration" under § 3(18)(B) was not satisfied. See 29 U.S.C. § 1002(18)(B). Therefore, the Court specifically rejects defendants' contention and finds that the price paid by a hypothetical reasonable fiduciary is irrelevant in determining whether defendants violated § 406(a)(1).

2. *Kuper v. Iovenko*

In addition, defendants also argue that were the Court to agree with the district court, it would ignore the holding in *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995). In *Kuper*, another panel in this circuit stated:

> However, a fiduciary's failure to investigate an investment decision *alone* is not sufficient to show. that the decision was not reasonable. Instead, to show that an investment decision breached a fiduciary's duty to act reasonably in an effort to hold the fiduciary liable for a loss attributable to this investment decision, a plaintiff must show a causal link between the failure to investigate and the harm suffered by the plan.

Id. at *1459* (emphasis in original) (citing *Diduck v. Kaszycki & Sons Contractors, Inc.*, 974 F.2d *270, 279* (2d Cir. 1992)). As explained by defendants, a showing of "causation" is required to show a violation of § 406. This Court disagrees with defendants' claim and finds that the holding in *Kuper is* inapplicable to the present case as *Kuper* only addressed violations of § 404, not § 406.

In *Kuper*, this Circuit was faced with the question of whether fiduciaries of an ESOP that only held stock of the employer could be held liable for failing to diversify or

liquidate its holdings. In that case, the plaintiffs were employees of a division of Quantum Chemical Corporation (hereinafter "Quantum") that participated in an ESOP. Quantum decided to sell the division in question to another corporation. The transaction was completed on April 17, 1989. However, a transfer of the ESOP's assets to the purchasing corporation was not completed for another eighteen months. During this eighteen month period, the value of Quantum's stock dropped from more than $50.00 a share to a little more than $10.00 a share. Members of Quantum's benefit committee testified that they never considered liquidating or diversifying the ESOP's assets during this eighteen month period even though they were aware of the following events that occurred during the period the transfer was pending:

> Quantum's recapitalization, which adversely affected Quantum's financial condition by increasing its debt burden, interest expense, and principal repayment; Quantum's decreased operational diversity; a major fire at one of Quantum's plants that hindered the company's production capacity; and a decline in Quantum's net sales and income.

Id. at 1450-51.

The plaintiffs filed suit against the defendants and raised multiple claims. All of the claims were dismissed except for the plaintiffs' claims under ERISA, which were based upon the drop of Quantum's stock price during the eighteen-month period the transfer of the ESOP's assets was pending. The positions of the plaintiffs and the defendants were as follows: "Plaintiffs argue that defendants breached their fiduciary duties by failing to

diversify or liquidate the ESOP funds during the pendency of the . . . transfer. Defendants counter that the terms of the Plan did not give them any discretion to diversify or liquidate the ESOP funds." *Id.* at 1457. Eventually, the Court held that the "plaintiffs have failed to present sufficient evidence that a reasonable fiduciary would have diversified or liquidated the ESOP. Accordingly, we hold that the district court did not err in determining that [the] defendants' failure to diversify or liquidate the ESOP funds was not a breach of their fiduciary duties." *Id.* at 1460.

As the above-discussion shows, a violation of § 406 was not at issue in *Kuper* because none of the prohibited transactions in § 404(a)(1) was at issue. Instead, at issue in *Kuper* was whether the defendants had violated their fiduciary duties under, § 404. The Court spent a great deal of time examining the fiduciary requirements of § 404, but, it did not examine a violation of § 406 because none of the prohibited transactions under § 406 were at issue. Consequently, the Court declines to read a "causation" element into a violation of § 406 because *Kuper* had no intention to do so and such a reading is far beyond the scope of the issues presented in that case.

Further, the Court finds that requiring a causal link between the failure to investigate and the resultant harm in order to prove a violation under § 406 would be contrary to Congress's intent in enacting § 406. Basically, in creating § 406(a), Congress intended to create a category of per se violations. *See Jordan v. Michigan Conference of Teamsters Welfare Fund,* 207 F.3d 854, 858 (6th Cir. 2000). As one court explained, the reasoning for treating a violation of § 406 as a per se violation is as follows:

> "Congress (in ERISA § 406) intended to create an easily applied per se prohibition . . . of certain transactions, no matter how fair, unless the statutory exemption procedures (of ERISA § 408(a)) are followed." *Cutaiar v. Marshall*, 590 F.2d 523, 529-30 (3d Cir. 1979); *see also Eaves v. Penn*, 587 F.2d 453, 457-59 (10th Cir. 1978). Lack of harm to the plan or the good faith or lack of the same on the part of the borrower are not relevant, and certainly not controlling, under ERISA § 406. Rather, "Congress was concerned in ERISA (§ 406) to prevent transactions which offered a high potential for loss of plan assets or for insider abuse. . . ." *(Marshall v. Kelly*, 465 F. Supp. 341, 354 (W.D. Okla.1978)).

Reich v. Valley Nat. Bank of Arizona, 837 F. Supp. 1259, 1281 (S.D.N.Y. 1993) (quoting *M & R Invest. Co., Inc. v. Fitzsimmons*, 484 F. Supp. 1041, 1055 (D. Nev. 1980)).

In sum, the claims of error raised by defendants under *Kuper* must fail. Defendants' contention that a causal link must be established between the loss to the Hall Chemical ESOP and defendants' failure to investigate cannot stand because *Kuper* did not contemplate a violation under § 406, and further, requiring such a causal link would be contrary to Congress's creation of per se violations under § 406.

3. *Jordan v. Michigan Conference of Teamsters Welfare Fund*

The third and final case which was relied upon by defendants is *Jordan v. Michigan Conference of Teamsters Welfare Fund,* 207 F.3d 854 (6th Cir. 2000). In their reply brief, defendants assert that this case compels reversal of the district court's decision because there was no showing of a subjective intent to benefit the parties in interest as defendants contend is required under § 406.

In *Jordan,* the plaintiffs brought a class action case against the defendants. The parties resolved the dispute and, as part of the settlement agreement, the defendants agreed to pay the plaintiffs' reasonable attorney's fees. The district court had a hearing during which it certified the class and preliminarily approved the settlement agreement. However, affidavits supporting the request. for attorney's fees disclosed that the International Brotherhood of Teamsters AFL-CIO helped to finance the plaintiffs' class action suit. The defendants refused to make any payments to the International Brotherhood of Teamsters AFL-CIO because they believed that such a payment would violate § 406(a)(1)(D), "which prohibits a benefit plan from transferring assets to a party in interest." The district court agreed with the defendants that such a transfer would be a prohibited transaction under § 4.06(a)(1)(D). Id. at 856-58.

However, another panel of this Court disagreed with the district court's conclusion and reversed. That panel adopted the following language in *Reich v. Compton,* 57 F.3d 270 (3d Cir. 1995):

> As we read this language [in § 406(a)(1)(D)], it provides that a fiduciary breach occurs when the following five elements are satisfied: 1) the person or entity is "[a] fiduciary with respect to [the] plan"; 2) the fiduciary "cause[s]" the plan to engage in the transaction at issue; 3) the transaction "use[s]" plan assets; 4) the transaction's use of the assets is "for the benefit of" a party in interest; and 5) the fiduciary "knows or should know" that elements three and four are satisfied.

Jordan, 207 F.3d at 860-61 (quoting *Compton*, 57 F.3d at 278). The panel in *Jordan* explained its reasons for adopting the holding in *Compton:*

> The court [in *Compton*] . . . concluded that the fourth element requires a subjective intent to benefit a party in interest. If a showing of subjective intent were not required, "section 406(a)(1)(D) would produce unreasonable consequences that we feel confident Congress could not have wanted." That is, § 406 would prohibit fiduciaries from engaging in transactions that would benefit the plan. "We thus find strong support for a subjective intent requirement in the language of section 406(a)(1)(D), and finding no contrary evidence in the legislative history, we conclude that element four requires proof of a subjective intent to benefit a party in interest."

Jordan, 207 F.3d at 861 (internal citations omitted). After noting that the defendants had never challenged the amount of attorney fees or hours, the court found that the "Defendants cannot now assert that they subjectively intended to benefit the [International Brotherhood of Teamsters AFL-CIO] by complying with the attorney's fees. agreement in the settlement." *Id.*

Although defendants' argument may give some pause, it is by no means dispositive of the present appeal. This Court reviews "the grant of summary judgment de novo and . . . may affirm on any grounds supported by the record, even though they may be different from the grounds relied on by the district court." *City Mgrnt. Corp. v. U.S. Chemical Co., Inc.*, 43 F.3d 244, 251 (6th Cir. 1994). In granting summary judgment, the district court found that defendants violated § 406(a)(1)(A) and § 406(a)(1)(D). *Jordan* and *Compton* are concerned with violations under § 406(a)(1)(D); however, neither case mentions a subjective intent requirement for § 406(a)(1)(A). Regardless of whether defendants had the subjective intent necessitated by *Jordan* and *Compton* in order to prove a violation of § 406(a)(1)(D),[13] the fact remains that

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[13] Although *Jordan* and *Compton* require a showing of subjective intent to benefit a party in interest for a violation under § 406(a)(1)(D), the Court notes its concern with these holdings. First, there appears to be inconsistencies in the *Jordan* opinion. The opinion states that "[t]his Court, as well as others, have [sic] noted that because § 406(a) characterizes per se violations, it should be interpreted narrowly." *Jordan*, 207 F.3d 858. However, the opinion also states that § 406(a)(1)(D) requires a showing of subjective intent to benefit a party in interest. Stating that § 406(a) "characterizes per se violations," and then holding that a violation of § 406(a)(1)(D) requires a showing of subjective intent, is inherently at odds. This is because a per se violation is a violation

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"[o]f, in, or by itself; standing alone, without reference to additional facts." BLACK'S LAW DICTIONARY 1162 (7th ed. 1999). Therefore, because it is a per se violation, the parties' intent should have no bearing as to whether a violation occurred.

Second, the panel in *Jordan,* while quoting *Compton;* states there is "strong support for a subjective intent requirement in the language of section 406(a)(I)(D)" and that there is "no contrary evidence in the legislative history." *Jordan,* 207 F.3d at 861 (quoting. *Compton* 57 F.3d at 280). However, the Court's review of the legislative history reveals the following:

> An additional problem exists because of the present definition of prohibited transactions. Currently, transactions generally are prohibited when the dealings involved are on other than an arm's-length basis. However, *arm's-length standards require substantial enforcement efforts, resulting in sporadic and uncertain effectiveness* of these provisions. This is the same problem which was faced by the Congress in 1969 when it acted with respect to prohibited transactions and private foundations. At that time the Congress concluded that in most cases *arm's-length standards did not preserve the integrity of private foundations, and amended these definitions of prohibited transactions for the most part to prohibit outright questionable transactions* between the trust and interested parties. The committee's bill generally follows the approach that was developed in 1969, *establishing definitions for prohibited transactions that will make it more practical to enforce the law.* The committee's definitions of prohibited transactions, and the exceptions from these definitions, however, are designed to take account of the unique situation of employee benefit trusts.

S. REP. No. 93-383, *reprinted in* 1974 U.S.C.C.A.N. 4890, 4979 (emphasis added). Although the Senate Report does not state that the prohibited transactions set forth in § 406(a)(1) are per se violations, it does note that the concern was to avoid "sporadic and uncertain effectiveness," which is the result of a per se rule. *Id.*

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Further, the Senate Report-notes that the intent was to "prohibit outright" these types of transactions. *Id.* Finally, the Congress was concerned with practical enforcement of the prohibited transactions. *See id.* Such legislative history evinces Congress's intent to create per se violations in § 406(a)(1).

Finally, the Court is also concerned that requiring subjective intent for a violation of § 406(a)(1)(D) is against the great weight of authority. Most courts and commentators have found that § 406(a) contemplates per se violations. *See Etter v. J. Pease Const. Co., Inc.*, 963 F.2d 1005, 1010 (7th Cir. 1992) (stating that no injury was required "for a court to find a transaction prohibited or otherwise impermissible"); *Brock v. Citizens Bank of Clovis*, 841 F.2d 344, 347 (10th Cir. 1988) (referring to the transactions listed in § 406 as per se violations); *Leigh v. Engle*, 727 F.2d 113, 123 (7th Cir. 1984) ("The *per se* rules of section 406 make much simpler the enforcement of ERISA's more general fiduciary obligations." (citing S. REP. No. 93-383, *reprinted in* 1974 U.S.C.C.A.N. 4890,4979)); *Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983) ("The object of Section 406 was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse."); *M & R Inv. Co., Inc. v. Fitzsimmons*, 685 F.2d 283, 287 (9th Cir. 1982) ("The party-in-interest prohibitions act to insure arm's-length transactions by fiduciaries of funds subject to ERISA. A transaction with a party in interest is prohibited under the presumption that it is not arm's-length. The result is a broad per se prohibition of transactions ERISA implicitly defines as not arm's-length."); *Eaves v. Penn*, 587 F.2d 453, 459 (10th Cir. 1978) (noting that under certain circumstances, a fiduciary may be released from the per se violations enumerated in § 406); *Huffer v. Herman*, No. C2-00-897, 2001 WL 345455, at * 6 (S.D. Ohio Apr 09, 2001) ("[T]here is no 'good faith' exception to ERISA's fiduciary provisions. [Section 406] sets forth certain transactions that are prohibited *per se.*"); *Gray v. Briggs*, 45 F. Supp.2d 316,326 (S.D.N.Y. 1999) ("The transactions covered by Section 406(a)(1) 'are per se violations of ERISA regardless of the motivation which initiated the transaction, the prudence of the transaction, or the absence of any harm arising from the transaction.'" (quoting *Reich v. Polera Bldg Corp.*, No. 95 Civ.

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3205, 1996 WL 67172, * 2 (S.D.N.Y. Feb. 15, 1996))); *Metzler v. Solidarity of Labor Org. Health & Welfare Fund,* No. 95 CIV. 7247, 1998 WL 477964 (S.D.N.Y. Aug 14, 1998), *aff'd Herman v. Goldstein,* 224 F.3d 128 (2d Cir. 2000), *cert. denied Goldstein v. Chao,* S. Ct. , 2001 WL 290239, (U.S. June 25, 2001) (referring to the per se prohibitions in § 406); *Polera Bldg Corp.,* 1996 WL 67172, * 2 ("Congress made it a per se violation of ERISA to conduct transactions [set forth in § 406(a)(1)] because they inherently compromise the duty of trust that is imposed on a fiduciary."); *Reich v. Valley Nat. Bank of Arizona,* 837 F. Supp. 1259, 1281 (S.D.N.Y. 1993) (explaining that actions taken in good faith which violate § 406 are still a violation because this is a per se rule); *McDougall v. Donovan,* 552 F. Supp. 1206, 1215 (N.D. 111. 1982) ("[i]t is apparent that Congress intended § [406] to be virtually a *per se* prohibition against the enumerated transactions."); Gina Marie Agresta-Richardson, *"Employee Stock Ownership Plans: Uncertainties Plaguing the Duties of the ESOP Fiduciary with Respect to Voting and Defensive ESOPs",* 14 AKRON TAX J. 91, 103 (1999) (footnotes omitted) ("ERISA § 406 imposes a list of prohibited transactions. Engaging in these transactions is a per se violation of ERISA."); Michael J. Collins, *It's Common, but is it Right? The Common Law of Trusts in ERISA Fiduciary Litigation,* 16 LAB. LAW. 391, 396 (2001) ("[S]ection 406 of ERISA delineates specific categories of transactions that are deemed to per se violate the fiduciary responsibility rules."); Ronald J. Cooke, ERISA PRACTICE AND PROCEDURE, § 6.12 (2d ed. Supp. 2000) (footnote omitted) ("In essence, the prohibited transaction rules of ERISA § 406 develop a per se rule prohibiting certain transactions between a plan and a party in interest."); Emmalind Garcia, *ERISA: Its Fiduciary Duties and Investments for Social Purposes,* 23 REV. JUR. U.I.P.R. 53, 73 (1988) (Section 406(a) "covers per se prohibitions"); James F. Jorden, Waldemar J. Pflepsen, Jr. & Stephen H. Goldberg, HANDBOOK ON ERISA LITIGATION, § 3.03[B][1] (2d ed. Supp. 2000) (footnotes omitted) ("Prohibited 'party in interest' transactions are often characterized by the courts as 'per se' violations of ERISA because liability may be imposed even where such transactions are entered into in good faith, where such transactions would be found to be prudent under

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defendants make no argument in their reply brief as to the violation of § 406(a)(1)(A), which has no subjective intent requirement. Therefore, the Court affirms the district court's decision based upon its finding of a violation of § 406(a)(1)(A).

D. Defendants' Third Claim of Error

Defendants' third claim of error deals largely with the district court's award of monetary damages. Because defendants' arguments are based upon faulty premises, and because they fail to cite any authority for their claims, they must fail.

1. Defendants' Arguments Concerning the Structure of Leveraged ESOPs

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ERISA's prudence standard, and where no harm results to the plan."); Howard Pianko & Stephen J. Nelson, *Special Issues Involving Broker-Dealers and their Employee Benefit Plan Clients,* 23 REAL PROP. PROB. & TR. J. 749, 756 (1988) ("ERISA section 406 contains a list of 'prohibited transactions' that represent per se violations of fiduciary duty."); Leslie L. Wellman & Shari J. Clark, *An Overview of Pension Benefit and Fiduciary Litigation under ERISA, 26* WILLAMETTE L. REV. *665, 700 (1990)* ("The object of [§ 4061 was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse."); Alan P. Woodruff, ERISA LAW ANSWER HANDBOOK, Q *7:7* (3d ed. 2001) (explaining that good faith is no defense to a violation of § 406 because the section contemplates per se violations); Matthew M. O'Toole, Comment, *The Disproportionate Effects of an ESOP's Proportional Voting,* 85 N.W. U. L. REV. *824, 857 (1991)* (describing violations under § 406 as per se violations).

Simply put, defendants make arguments in their brief which would confound any rational investor. For example, defendants make the following claim:

> First and perhaps foremost, the ESOP participants do not have a direct interest in obtaining the lowest possible price for the stock at the inception of the ESOP since their ownership does not occur until later. Indeed, the moment the sale takes place, the ESOP participants' only interest is in obtaining the *highest* possible price since they are going to be sellers of the stock in the future when they become entitled to receive distributions from the ESOP.

(Emphasis in original). The Court is at a loss to understand defendants' argument. It appears as though defendants are arguing that at the time the shares of stock are transferred from an employer to the ESOP, it is in an employee's benefit to have the stock at the highest possible price. This makes little sense. At the time the ESOP acquires the stock, it is in the ESOP participant's best interest to do so at the lowest price possible. The lower the price of the stock, the more shares that can be purchased by the ESOP, assuming the investor will invest the same amount without regard to the price per share. Further, a higher return on investment can be generated with a lower purchase price.

Although it is true that in the present case defendant GFGI and defendant Goldman only wished to sell 9.96% of Hall Holding stock, it is easy to see why a lower stock price would benefit the ESOP in a factual scenario similar to the present case. In the present case, the transaction was structured as a leveraged ESOP. In order to complete the transaction, the Master Trust loaned the Hall Chemical

ESOP $3.5 million to purchase the shares. As the district court explained in its initial opinion, the 110 shares of Hall Holding were placed in a suspense account. *See Hall Holding,* 990 F. Supp. at 957. Hall Chemical made cash contributions which were used to retire the $3.5 million loan. As each payment was made, a corresponding amount of stock was released from the suspense account and placed into the individual participant's accounts. Assuming that the Hall Chemical ESOP would have paid the amount the district court determined was proper, $2,450,451.00, the participants in the Hall Chemical ESOP would have benefitted. Because the amount of the debt would have been more than $1 million less than the actual purchase price of $3.5 million, it could have been retired much more quickly. Consequently, participants in the Hall Chemical ESOP would have been fully vested in the 110 shares of Hall Holding stock sooner.

Defendants also raise another baffling argument in their brief: "[F]rom the perspective of the ESOP participants, the beginning price of their stock is irrelevant; what counts is what the stock is worth when they retire." Again, this argument fails to realize the realities of investing. The participants in the Hall Chemical ESOP have every incentive to purchase the stock at the lowest possible price. Had the stock been purchased at a lower price, the plan participants could have-purchased more shares and realized a larger return. For example, suppose two investors each have $100.00 to invest. Investor A purchases 10 shares of X corporation at $10.00 a share while investor B purchases 5 shares of X corporation at $20.00 a share. A few years later, both investors wish to sell their stock when a share is selling for $50.00. Investor A now has 10 shares worth $500.00 dollars, representing a profit of $400.00, whereas investor

B has 5 shares worth $250.00, representing a profit of $150.00 dollars.

This example demonstrates two things. First, a plan participant is definitely concerned with the value of Hall Holding Stock at the time he or she retires. However, defendants are wrong in asserting that this is the participants' only concern. This is because the example also demonstrates that an investor is also concerned with the price that he or she must pay to purchase the stock as it directly affects the return a participant could hope to receive.

Finally, defendants make the following statement:

> Under either the actual price or the district court's version of fair market value, the ESOP would still own 9.96% of Hall Holding and the participants would be in the exact same position they are in today: they would have exactly the same number of shares in their accounts valued at whatever those shares are worth today.

The difficulty with this argument is that it again gives no consideration to the original price paid for the shares. Benefits such as an ESOP "are not a gratuity, *see Inland Steel Co. v. NLRB,* 170 F.2d 247 (7th Cir. 1948), *cert. den.* 336 U.S. 960, 69 S. Ct. 887, 93 L. Ed. 1112 (1949), but a form of deferred wages." *Reich v. Valley Nat. Bank of Arizona*, 837 F. Supp. *1259, 1286-87 (S.D.N.Y. 1993).* Defendants, by arguing that the initial price of the stock does not matter, essentially ignore the fact that the money paid for the Hall Holding stock was a form of deferred compensation for the participants in the Hall Chemical ESOP. However,

because the Hall Chemical ESOP overpaid for the shares of Hall Holding stock, it suffered a loss. Consequently, this argument, like the others, cannot stand.

2. The District Court's Remedy

Defendants' final argument is that the district court, in distributing cash to the Hall Chemical ESOP participants "would constitute . . . benefits for the ESOP participants that they never earned nor expected, nor, more seriously, could obtain legally under the Internal Revenue Code." Again, this argument must also fail.

First, defendants' statement that the Hall Chemical ESOP participants did not earn the benefits is simply not true. As stated previously, benefits such as an ESOP "are not a gratuity . . . but a form of deferred wages." *Valley Nat. Bank*, 837 F. Supp. at 1286-87. Second, although it is true that at the inception of the Hall Chemical ESOP, the participants may not have anticipated a cash distribution, they certainly did anticipate paying adequate consideration, and nothing more, for the stock in Hall Holding. However, because of defendants' actions, the Hall Chemical ESOP overpaid for the stock by more than $1 million. Third, defendants argue, with no citation to authority, that such a distribution would violate the Internal Revenue Code. Defendants only refer the Court, with no explanation, to a litigation report submitted to the district court. However, a cursory review of the report shows that it does not even contemplate the figures at issue on appeal. Instead, it deals with figures based upon the Secretary's valuation of the Hall Holding stock which were in issue at a very early stage in this litigation.

Finally, a district court is given wide latitude in compensating the participants in an ESOP when a breach

of fiduciary duty has been shown. "[1]t is `clear that Congress intended to provide the courts with broad remedies for redressing the interests of participants and beneficiaries when they have been adversely affected by breaches of a fiduciary duty.'" *Donovan v. Bierwirth*, 754 F.2d at 1055 (quoting *Eaves v. Penn*, 587 F.2d 453, 462 (10th Cir. 1978) (citing S. REP. NO. 93-127, *reprinted in* 1974 U.S.C.C.A.N. 4838, 4871)). Because defendants have provided no authority to show that the district court erred in awarding money damages to compensate the participants in the Hall Chemical ESOP, the Court finds that the award granted by the district court shall stand.

V. CONCLUSION

For the above-stated reasons, the district court properly granted the Secretary's motion for summary judgment. Consequently, the decision of the district court is AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ROBERT B. REICH, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al., Defendants.	)	MEMORANDUM AND ORDER

This action arises under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §1001, et. sec., as amended. The Secretary of the United States Department of Labor (the "Secretary") is suing Hall Holding Company, Inc., David L. Goldman, Kathleen A. Keating, George P. Ahearn, Michael F. Shields, and Goldman Financial Group, Inc. ("defendants") for allegedly violating various provisions of ERISA. The Secretary claims that the defendants breached their duties as fiduciaries by purchasing stock on behalf of an employee stock ownership plan ("ESOP") for more than adequate consideration as defined by ERISA. The defendants have moved for summary judgment, or in the alternative, partial summary judgment (doc. 54), and the Secretary has moved for partial

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action. (Doc. 71)

summary judgment (doc. 59). Both motions are opposed. For the following reasons, this Court denies both motions.

I.

ERISA is a "comprehensive statute designed to promote the interests of employees and their beneficiaries in employee benefit plans." Shaw v. Delta Air Lines. Inc., 463 U.S. 85, 90 (1983). ERISA regulates employee benefit plans, in part, by establishing strict standards of conduct, responsibilities and obligations for fiduciaries of the plans. 29 U.S.C. § 1001(b). A type of plan covered by the provisions of ERISA is an employee stock ownership plan ("ESOP").

"An ESOP is a type of ERISA plan that invests primarily in the stock of the employer creating the plan." Roth v. Sawyer-Cleator Lumber Co., 16 F.3d 915, 917 (8th Cir. 1994); see also 29 U.S.C. § 1107(d)(6). ERISA governs the creation, maintenance and administration of ESOPs through a number of somewhat complex and interrelated rules. An employer desiring to create an ESOP is required to execute a written document to define the terms of the plan and the rights of the beneficiaries under it. 29 U.S.C. § 1102(a). This plan must also name one or more fiduciaries who are "to control and manage the operation and administration of the plan." Id. A trust is established to hold the assets of the ESOP. 29 U.S.C. §1103(a). An ESOP's assets are often derived from tax-deductible contributions from the employer to the plan in the form of the employer's own stock or cash. If cash is contributed, the ESOP then purchases stock in the sponsoring company. An ESOP may also borrow money from a third party in order to invest in the employer's stock. 29 U.S.C. §1108(b)(3). This type of ESOP is called a leveraged ESOP and is the type of ESOP at issue in the present case. If a leveraged ESOP is created, the

employer is obligated to make cash contributions to the ESOP, which in turn uses the cash to retire the loan debt. Donovan v. Cunningham, 716 F.2d 1455, 1459 (5th Cir. 1983). In the present case, after the ESOP borrowed money for the amount of the stock purchase, the stock was placed in a "suspense account." As the ESOP makes loan payments using the cash contributions from the corporate sponsor, stock is released from the suspense account and placed into the ESOP participants' individual accounts.

Defendant Goldman Financial Group, Inc. ("GFGI") is a corporation which manages several different businesses, including Hall Chemical Company ("Hall Chemical"). GFGI owns Hall Chemical through the defendant Hall Holding Company, Inc. ("Hall Holding"), a holding company and subsidiary of GFGI. Hall Holding's primary asset is Hall Chemical.

During the relevant time period, defendant David L. Goldman ("Goldman") was chairman and president of GFGI. He was also the sole member of the Board of Directors of Hall Chemical, as well as the sole director of Hall Holding. Goldman authorized the establishment of the Goldman Financial Group, Inc. Master Trust ("Master Trust"), which is a trust containing assets of several ERISA-covered plans sponsored by GFGI and/or its affiliates.

Since May of 1989, defendant Kathleen A. Keating ("Keating") has been the Director of Human Resources for GFGI. In September of 1990, she also directed the Master Trust trustee on how to invest the assets held in the Master Trust.

Defendant George P. Ahearn ("Ahearn") was the president and chief operating officer of Hall Chemical from

July 1988 until he was terminated in July 1991. Defendant Michael F. Shields ("Shields") acted as Hall Chemical's vice president of finance and chief financial officer from June 1988 through June 1992.

In August of 1990, GFGI, acting primarily through Keating and GFGI's outside ERISA counsel, James Shumaker, began designing a new ESOP for the employees of Hall Chemical. GFGI decided to create a leveraged ESOP. The ESOP, upon being established, would borrow money which it would use to purchase qualifying employer securities. GFGI paid James Cunningham, a person whom Keating and other GFGI officials believed to be well-qualified, to perform a valuation of Hall Chemical stock.

Approximately four months earlier, Cunningham, while still a partner at an investment banking firm named First Boston Corporation, had been involved in a valuation of Hall Chemical for purposes unrelated to the ESOP. Not surprisingly, the results of Cunningham's valuation report were consistent with those of First Boston. On September 5, 1990, based upon information provided by GFGI, Cunningham concluded that the estimated value of Hall Chemical excluding net debt was $32.4 -$37.4 million.

At the time GFGI retained Cunningham, Keating and other GFGI officials believed the ESOP would purchase Hall Chemical stock. However, after Cunningham had completed his valuation of Hall Chemical, it was decided that the ESOP should purchase stock in Hall Holding, the company which owned Hall Chemical. Considering that Hall Chemical was Hall Holding's primary asset, GFGI officials believed it was appropriate to rely on Cunningham's valuation of Hall Chemical to determine the value of Hall Holding. GFGI officials established the value of all Hall Holding stock at $35

million, which is the approximate mid-point of Cunningham's estimated range. Based on this $35 million figure, Goldman, in his capacity as sole director of the seller (Hall Holding), agreed that Hall Holding would sell 9.9% of its stock (110 shares) to the ESOP in exchange for $3.5 million.

After the terms of the loan needed to finance the above-described stock purchase were reviewed and discussed, Keating, after consulting with Shumaker, determined that the ESOP, after its establishment, could borrow money from the Master Trust in the amount of $3.5 million, the appropriate purchase price of the 110 Hall Holding shares as determined by GFGI officials. The trustee of the Master Trust, Boston Safe Deposit and Trust Company ("BSDT"), although it had initial concerns regarding the relationship between the parties (the Master Trust held assets of other GFGI-related plans), ultimately agreed to the transaction.

Finally, in September of 1990, the ESOP for the employees of Hall Chemical was established. The ESOP is entitled the Hall Chemical Company, Inc. Employee Stock Participation Plan ("Hall ESPP"). On September 12, 1990, Goldman, in his capacity as sole director of Hall Holding, appointed Ahearn and Shields as members of the Hall ESPP Committee, which serves as Plan Administrator for the Hall ESPP. According to the Hall ESPP Plan Document, the Plan Administrator has the authority to control and manage the operation and administration of the ESPP. Aheans and Shields also acted as trustees of the Hall ESPP from September 1990 through April 1991.

On September 18, 1990, Keating, on behalf of GFGI, directed BSDT to loan $3.5 million from the Master Trust to the Hall ESPP. On that same day (according to the date on

the promissory note), Ahearn and Shields, as trustees of the Hall ESPP, signed the promissory note containing the terms previously established by Keating and other GFGI representatives. On September 20, the loan was approved.

On September 21, 1990, after the Hall ESPP received the $3.5 million in loan proceeds, Ahearn and Shields signed a subscription which "consummated [the stock purchase] in accordance with GFGI's prior decisions by purchasing 110 shares, or 9.9%, of Hall Holding stock at a price of $3.5 million." Memorandum in Support of Defendants' Motion for Summary Judgment at 12. Upon purchase, the 110 shares of Hall Holding stock were placed in a "suspense account" to be released as the loan payments were made. Hall Chemical was responsible for making cash contributions to the Hall ESPP, who, in turn, was to use the contributions to make the loan payments. As the Hall ESPP made loan payments using the cash contributions from Hall Chemical, the Hall Holding stock was to be released from the suspense account and placed into the Hall ESPP participants' individual accounts.

The defendants have moved for summary judgment claiming that their decisions challenged by the Secretary were corporate or "plan sponsor" decisions, not fiduciary decisions subject to ERISA's fiduciary standards. In the alternative, the defendants move for partial summary judgment on the ground that the ESOP and its participants have suffered no loss as a result of the defendants' alleged fiduciary breaches. The Secretary of Labor has moved for partial summary judgment based on the argument that the defendants caused the Hall ESOP to engage in a prohibited transaction in violation of §406 of ERISA, specifically 29

U.S.C. §1106(a)(1)(A) and (D)[2] The alleged prohibited transaction was the purchase of Hall Holding stock for more than adequate consideration. The Court will first address the defendants' motion.

II.

A. Sponsor/Fiduciary Distinction

The defendants argue that they are entitled to summary judgment because the conduct which the Secretary is challenging, the stock purchase and related loan transaction, is simply not within the purview of ERISA's fiduciary provisions. The defendants argue that their decisions regarding the ESOP's purchase of Hall Holding stock and loan transaction with the Master Trust were corporate decisions, not fiduciary decisions subject to ERISA's fiduciary standards.

ERISA recognizes the symbiotic relationship between the employer, or plan "sponsor," and its employee benefits plan. For example, §408(c)(3) allows officers, employees and other representatives of an employer or other party in interest to serve as fiduciaries to a plan. Moreover, ERISA §3(21)(A), which defines the term fiduciary, limits the scope of a fiduciary's responsibilities by using the phrase "to the extent."[3] This limiting language

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[2] The Secretary has not moved for summary judgment on the defendants' alleged violation of ERISA §404(a)(1) in connection with the stock purchase, nor is the Secretary seeking summary judgment on the defendants' alleged violations of §§404 and 406 in connection with the loan transaction between the Hall ESPP and the Master Trust.

[3] Section 3(21)(A) provides:

(continued...)

releases the employer or employer's representatives, who are also fiduciaries to a plan, from the fiduciary standards of care and loyalty when they are acting in their corporate capacities, rather than in their fiduciary roles.

The Sixth Circuit has respected the necessary distinction between fiduciaries and sponsors. "[W]hen an employer decides to establish, amend, or terminate a benefits plan, as opposed to managing any assets of the plan and administering the plan in accordance with its terms, its actions are not to be judged by fiduciary standards." Musto v. American General Corp., 861 F.2d 897, 912 (6th Cir. 1988). The defendants in the present case argue that their actions and decisions surrounding the loan transaction and stock purchase should not be judged under ERISA's fiduciary standards because the loan and stock transactions were part of the establishment of the Hall ESPP. In making this argument, the defendants rely heavily on the recent Sixth Circuit decision in Akers v. Palmer, 71 F.3d 226 (6th Cir. 1995), cert. denied, 116 S.Ct. 2523 (1996).

(...continued)

> [A] person is a fiduciary to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

29 U.S.C. §1002(21)(A) (emphasis added).

In Akers, the plaintiffs challenged certain corporate board actions leading to the creation and initial funding of an ESOP for the benefit of the employees of Alco Gravure, Inc. ("Alco"). The plaintiffs claimed that the founding board members engaged in self-dealing and violated their fiduciary duties by purchasing all of Alco's outstanding shares of common stock at a price well below the fair market value, and then initially funding the ESOP with contributions of those same shares at their fair market value. When Alco was sold several years after the creation of the ESOP, the founding stockholders made a very large profit on their investment, while the ESOP merely doubled its money.

The Sixth Circuit rejected the plaintiffs' argument that the board members violated their fiduciary duties explaining that "a company is only subject to fiduciary restrictions when managing at plan according to its terms, but not when it decides what those terms are to be. ERISA is simply not involved in regulating conduct affecting the establishment of a plan or with its terms." Akers, 71 F.3d at 230. The Akers Court held that the corporate board members' actions in funding the ESOP were not fiduciary actions, but rather purely corporate or "sponsor/settlor" actions. The defendants in the present case strenuously argue that their actions, like those of the board members in Akers, were sponsor actions not subject to the fiduciary provisions of ERISA.

Contrary to the defendants' claims, however, Akers is readily distinguished from the present case. Unlike the situation before this Court, the ESOP in Akers "acquired no debt to obtain the shares, nor were there any plan 'assets' used to 'purchase' the shares. To be sure, the shares themselves constituted the original plan assets. They were, in essence, a gift from the employer to the employees." Id.

at 230. In the present case, immediately following its creation, the Hall ESPP acquired a debt of $3.5 million in loan money, which it then used to purchase the Hall Holding shares. The Hall ESOP's original plan assets were the 3.5 million dollars in loan money. Under the plain language of ERISA, the fiduciary provisions apply to the defendants' conduct regarding the ESOP's loan transaction and stock acquisition because "a person is a fiduciary to the extent . . . he exercises any authority or control respecting management or disposition of [a plan's] assets." 29 U.S.C. §1002(21)(A). Furthermore, in the specific context of an ESOP's purchase of employer securities, ERISA explicitly requires the plan's fiduciaries to ensure that the stock is purchased for "adequate consideration" by conducting an independent investigation to determine the fair market value of the to-be-acquired securities. 29 U.S.C. §§ 1002(18) and 1108(e); Donovan, 716 F.2d at 1467. Finally, the Akers court itself held that "actions respecting the administration or management of plan 'assets' are subject to fiduciary standards." Akers, 71 F.3d at 230 (emphasis added); see also Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir. 1995) ("ERISA imposes high standards of fiduciary duty upon those responsible for administering an ERISA plan and investing and disposing of its assets.") (emphasis added). Therefore, this Court rejects the defendants argument that their actions surrounding the financing and purchase of Hall Holding stock by the Hall ESPP are not subject to the fiduciary provisions of ERISA,[4] and summary judgment on that ground is denied.

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[4] The defendants also argue that a necessary corollary of the sponsor/fiduciary distinction is that trustees who merely execute plan sponsor design determinations are not subject to ERISA's fiduciary provisions. However, as discussed above, determining the appropriate disposition and management of an ESOP's assets, which is the activity

(continued...)

B. No Loss Argument

In the alternative, the defendants assert that even if they were subject to the fiduciary provisions of ERISA, and even if they violated those provisions, they are entitled to partial summary judgment with respect to the relief available. The defendants argue that, in order to be awarded monetary relief, the Secretary must prove that the participants suffered a loss as a result of the defendants' alleged breaches of fiduciary duty with regard to the loan and stock purchase. The defendants cite ERISA §409, which provides that "a fiduciary . . . shall be personally liable to make good to such plan any losses to the plan resulting from each such breach." 29 U.S.C. § 1109. In making this assertion, the defendants essentially argue that Hall Chemical's cash contributions to the Hall ESPP, which were used to pay off the Hall ESPP'' debt resulting from the stock purchase, were gifts - nothing was given up by the ESOP participants in exchange for the Hall Holding stock. The Court finds these arguments indefensible as a matter of law, and denies summary judgment on this ground.[5]

The defendants' argument that the participants suffered no loss because the contributions were gifts ignores the fact that the Hall ESPP, which the defendants created, provides a form of deferred compensation to the plan's participants. The Hall ESPP'' own governing plan

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(...continued)

primarily challenged in this case, is a function of the ESOP's fiduciaries, not the ESOP's sponsor.

[5] The Court further discusses the issue of loss in its analysis of the Secretary's motion for partial summary judgment.

indicates this fact. The plan document explicitly disallows any and all contributions to the ESOP from Hall Chemical that are non-deductible. Plan Document § 1.2. Section 404(a) of the Internal Revenue Code allows an employer to deduct contributions to tax-qualified retirement plans to the extent that they are "ordinary and necessary business expenses during the taxable year in carrying on the trade or business or for the production of income and are compensation for personal services actually rendered." 26 C.F.R. § 1.404(a)-1(b) (emphasis added). Therefore, since the defendants conditioned all ESOP contributions on their deductibility as compensation for the participants' services to the company, and took advantage of such deductions, the defendants may not now argue that Hall Chemical's contributions were gifts. Rather, the contributions must be viewed as a form of deferred compensation. To assume otherwise would be tantamount to a decision that the defendants have improperly withheld a large amount of tax revenue from the federal government.

Because Hall Chemical employees earned the ESOP contributions from Hall Chemical by performing services for Hall Chemical, the employees suffered a loss if the stock purchased by the ESOP was worth less than the full value of those contributions. In other words, if the Hall Holding stock was not worth what the ESOP paid for it, the ESOP and its participants suffered a loss under ERISA §409.

The defendants state that if they had taken the position that the 110 shares of Hall Holding stock were only worth $918,000, as the Secretary's expert opines was the true value of the shares when purchased, only three alternative outcomes could have occurred. First, Hall Holding would have refused to sell at that price, leaving the ESOP participants with nothing and thereby placing the

participants in a worse position than they are now. In making this argument, the defendants fail to acknowledge "the fact that while an employer is under no obligation to establish an ESOP, once it does so ERISA's fiduciary standards apply." Valley Nat'l Bank, 837 F. Supp. at 1287. As explained previously, because the loan money received by the Hall ESPP constituted plan assets, the defendants' decision to invest those assets was subject to ERISA's fiduciary standards. The defendants may not be relieved of their fiduciary duty to obtain adequate consideration for the Hall Holding stock by virtue of the fact that if they had not agreed to buy the stock for less than adequate consideration, Hall Holding would not have sold its stock. To hold otherwise would be contrary to §410(a) of ERISA which forbids any agreement "which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation or duty . . . [as] void as against public policy." 29 U.S.C. § 1110(a). See also Valley Nat'l Bank, 837 F. Supp. at 1288 (employer cannot condition plan contributions on a violation of ERISA because ERISA §410(a) forbids such an agreement).

The defendants' second and third projected outcomes appear to demonstrate a misunderstanding of the concept of fair market value. The second scenario suggested by the defendants is that if, in the unlikely event Hall Holding had agreed to sell 110 shares of its stock to the Hall ESPP for only $918,000, instead of the $3.5 million actually paid, the participants would somehow be left with less benefits than they presently have[6] However, the value of the 110 shares today is not dependent upon the

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[6] The defendants state that they have presented the testimony of Robert Fitzpatrick to support this assertion, but the Court is unable to locate such testimony in the record.

original purchase price of those shares in 1990. Rather, the present value of the shares depends on their present fair market value.

The third suggested outcome completely puzzles this Court. The defendants hypothesize that they could have insisted on purchasing three times the amount of stock actually purchased, or 330 shares, in exchange for $3.5 million. The defendants argue that this would have left the ESOP precisely in the same position as it is today - holding stock worth a total of $3.5 million. Clearly, however, if the, present fair market value of 110 shares of stock is $3.5 million,[7] then the present fair market value of 330 shares of stock would be considerably higher, three times higher to be precise.

In sum, this Court rejects the defendants' characterization of the ESOP cash contributions as gifts, and finds that the defendants have misconstrued portions of ERISA and the concept of fair market value in arguing that the ESOP and its participants have suffered no loss. The Court denies partial summary judgment on this ground and holds that if the ESOP purchased stock that was worth less than the full value of the contributions, the ESOP and its participants suffered a loss.

III.

The Secretary has moved for partial summary judgment based on the argument that the defendants, as fiduciaries, caused the Hall ESOP to engage in a prohibited

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[7] The defendants have presented undisputed evidence that recent independent valuations of Hall Holding stock are consistent with Cunningham's 1990 final valuation figures.

transaction in violation of §406 of ERISA, specifically 29 U.S.C. §1106(a)(1)(A) and (D). The prohibited transaction allegedly caused by the defendants was the ESOP's purchase of Hall Holding stock for more than adequate consideration.

Section 406 of ERISA lists several transactions that are specifically prohibited and illegal per se because of their high potential for abuse. Donovan, 716 F.2d at 1464-1465. The prohibited transactions of relevance to the present case are a "sale or exchange, or leasing, of any property between the plan and a party in interest" and a "transfer to, or use by or for the benefit of a party in interest, of any assets of the plan." 29 U.S.C. § 1106(a)(1)(A) and (D). A "party in interest" includes any fiduciary, employer of employees covered by the plan, or employee, officer or director of such employer. 29 U.S.C. §1002(14). Therefore, the purchase of employer securities by a plan is a prohibited transaction under §406 because of the high risk of self-dealing.

However, because Congress did not wish to prohibit employers from providing their employees with the opportunity of owning a portion of their employers' stock, §408 of ERISA grants ESOPs and certain other ERISA-covered plans a conditional exemption from the prohibited transaction rules for purchase of employer securities. ESOPs may purchase employer securities if the purchase is made for "adequate consideration." 29 U.S.C. § 1108(e). Section 3(18) of ERISA defines "adequate consideration" in the case of assets for which there is no generally recognized market as "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. § 1002(18).

The Fifth Circuit in Donovan v. Cunningham examined §408's conditional exemption and how to determine whether fiduciaries purchased securities for

"adequate consideration." The Donovan court explained that although ESOP fiduciaries are "freed by Section 408 from the prohibited transaction rules, ESOP fiduciaries remain subject to the general requirements of Section 404." Donovan, 716 F.2d at 1467; see also Kuper, 66 F.3rd at 1458 (holding that §408 exemption for ESOPs do not relieve fiduciaries from the general fiduciary responsibility provisions of §404). Section 404 imposes three distinct but overlapping duties.[8] ERISA fiduciaries must act "solely in the interest of plan participants and beneficiaries," for the "exclusive purpose" of providing benefits to them, and as a prudent persons would act under the circumstances. Kuper, 66 F.3d at 1458. These fiduciary duties have been characterized as "the highest known to law." Kuper, 66 F.3d at 1453 (quoting Sommers Drug Stores Co. Employee Profit

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[8] Section 404(a)(1) reads in relevant part as follows:

> (1). . . a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and -
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> (A) for the exclusive purpose of-
>
> (i) providing benefits to participants and their beneficiaries; and
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> (ii) defraying reasonable expenses of administering the plan;
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
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> ***
>
> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

29 U.S.C. §1104(a)(1).

Sharing Trust v. Corrigan Enterprises. Inc., 793 F.2d 1456, 1468 (5th Cir. 1986)).

"[Fiduciaries'] principal responsibility in selecting investments is to act `with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.'" Donovan, 716 F.2d at 1467 (quoting 29 U.S.C. §1104(a)(1)(B)). The Donovan court held that "the ESOP fiduciaries will carry their burden to prove that adequate consideration was paid by showing that they arrived at their determination of fair market value by way of a prudent investigation in the circumstances then prevailing." Id. at 1467-1468. The fiduciary's burden of proof is by a preponderance of the evidence. Valley Nat'l Bank, 837 F. Supp. at 1272.

Therefore, the question before this Court for purposes of deciding the Secretary's motion for partial summary judgment is whether the defendants, in their capacities as fiduciaries,[9] can prove by a preponderance of the evidence

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[9] The only argument the defendants make to contest the Secretary's position that each defendant is a fiduciary under ERISA is that the actions and decisions of the defendants surrounding the stock purchase were corporate or sponsor actions not subject to ERISA's fiduciary standards. As discussed above, this argument is rejected. The defendants have not otherwise challenged the Secretary's characterization of them as fiduciaries. In fact, the defendants explicitly state that if the Court does reject their sponsor/fiduciary distinction argument, they "are not afraid to argue this case on the Secretary's theory." Defendant's Opposition to Plaintiffs' Motion for Partial Summary Judgment at 3. Therefore, in light of the defendants' position and this Court's own legal opinion that the defendants were indeed fiduciaries, the Court holds that the defendants were Hall ESPP fiduciaries during the time in question.

that they conducted a prudent investigation under the circumstances to determine the fair market value of the stock purchased by the ESOP as required by ERISA §408(e) and §3(18).

The defendants argue that they did conduct a prudent investigation to determine the fair market value of the Hall Holding stock. However, the arguments and evidence presented by the Secretary and the defendants show that although the defendants were involved to varying degrees in an investigation into the value of the stock, none of the defendants were investigating nor acting on behalf of the ESOP. Certainly, the defendants were not acting "solely in the interest of plan participants and beneficiaries" as required by ERISA §404. Rather, they were acting as employees and representatives of GFGI and/or Hall Chemical.

In fact, the defendants directly state that the ESOP trustees did not have "any discretion whatsoever about how to invest the loan proceeds at the establishment of the ESOP," but rather simply carried out "a pre-determined step in an integrated sponsor-directed program." Memorandum in Support of Defendants' Motion for Summary Judgment at 19 (emphasis added). Unfortunately for the defendants, as this Court held above, the investment of a plan's assets is a fiduciary function, and an ESOP trustee or fiduciary must, by statutory definition, have discretion to act in accordance with the best interest of the ESOP and its participants when deciding if and how to invest the ESOP's assets. See 29 U.S.C. §1104(a)(1); Cf. Kuper, 66 F.3d at 1457 ("a fiduciary's argument that he was prohibited from diversifying an ESOP under the terms of the plan was untenable because it was `inconsistent with ERISA inasmuch as it constrain[ed] the [fiduciary's] ability to act in the best interest of the beneficiaries"') (citing with approval the third circuit's holding in Moench v. Robertson, 62 F.3d 553, 567

(3d Cir. 1995)). This mandatory fiduciary discretion is particularly important in transactions involving the purchase by an ESOP of its sponsor's securities. Congress clearly intended the fiduciaries' strict duties of care and loyalty to safeguard such transactions from the danger of self-dealing.

In addition to the seeming admission in the defendants' pleadings that no one was acting on behalf of the ESOP when it was determined how much the ESOP would pay for the Hall Holding stock, other evidence exists in the record leading to the same conclusion. For example, Ahearns' and Shields' deposition testimony bolsters the defendants' admission that the trustees did not have discretion about how to invest the plan's assets. Ahearn explained that he did not have any input into the determination of the $3.5 million purchase price; rather, he was informed of the price the ESOP was to pay by Keating. Ahearn Dep. at p. 49 at 3-9, p. 50 at 1-5. Likewise, Shields also does not appear to have had any input into the decision to cause the ESOP to pay $3.5 million for the Hall Holding shares. Shields Dep. p. 91 at 22-25, p. 92-93 at 25, 1-3, p. 94 at 15-18. In fact, Ahearn and Shields did not even know they were appointed as plan administrator; both thought Keating was acting as the plan administrator. Ahearn Dep. p. 35 at 15-23; Shields Dep. p. 51 at 13-16, p. 52 at 2-7. However, Keating made clear in her deposition testimony that she was not acting as plan administrator. Keating Dep. p. 139 at 19-21. Thus, it is clear that no one was analyzing the Cunningham valuation or the final stock price "with an eye single to the interests of the participants and beneficiaries," as is required by ERISA. Donovan v. Bierwirth, 680 F.2d
263, 271 (2d Cir.), cert. denied, 459 U.S. 1069 (1982).

This Court finds that the defendants, as the ESOP's fiduciaries, did not conduct a prudent and independent

investigation to determine the fair market value of the stock purchased by the ESOP. However, this finding alone is not enough to sustain a holding that the defendants violated ERISA §406. As the Sixth Circuit held in Kuper,

> a fiduciary's failure to investigate an investment decision alone is not sufficient to show that the decision was not reasonable. Instead, to show that an investment decision breached a fiduciary's duty to act reasonably in an effort to hold the fiduciary liable for a loss attributable to this investment decision, a plaintiff must show a causal link between the failure to investigate and the harm suffered by the plan.... In order to establish this causal link, a plaintiff must demonstrate that an adequate investigation would have revealed to a reasonable fiduciary that the investment at issue was improvident.

Kuper, 66 F.3d at 1459-60 (citations omitted); see also Fink v. National Savings & Trust Co., 772 F.2d 951, 962 (D.C. Cir. 1985) (Scalia, J., concurring in part and dissenting in part) (arguing that where a fiduciary fails to conduct an adequate investigation, he or she is not liable for damages if he or she "happened - through prayer, astrology or just blind luck - to make . . . objectively prudent investments").

Therefore, for purposes of deciding the Secretary's summary judgment motion, this Court must decide whether an objective, reasonable fiduciary would have concluded, after conducting a prudent investigation, that $3.5 million was too high a price to pay for 110 shares of Hall Holding stock. A key component of most prudent investigations into the fair market value of closely-held stock is an expert's valuation of the stock. The Secretary argues that the report

of her expert, Myron Marcinkowski, conclusively proves that a reasonable fiduciary would not have relied on the Cunningham valuation, and further provides the Court with a valuation on which a reasonable fiduciary could rely, and from which the Court can determine damages. In contrast, the defendants argue, through the testimony of their expert, Karen Brown, that an objective, reasonable fiduciary could have properly relied on the Cunningham valuation to establish Hall Holding's value at $35 million, and consequently no damages exist.

The Court finds that it is unable to deduce from the record which, if either, party is correct, especially considering that the Court notices probable flaws in both Cunningham's and Marcinkowski's valuations. For example, Marcinkowski's valuation relies in part on the assumption that Hall Holding only owned 95% of Hall Chemical at the time of the stock purchase, when it appears from the defendants' statements that Hall Holding owned 100% of Hall Chemical. Cunningham admits in his deposition that he assumed that he was to value 100% of the Hall Chemical stock;[10] he was unaware of the fact that the ESOP would only be purchasing a minority share of stock. He himself goes on to state that he probably would have applied some sort of minority discount to his calculations had he known of this fact. Cunningham Dep. p. 107 at 11-20.

Therefore, it appears to the Court that there is a genuine issue of material fact as to whether a reasonable fiduciary would have relied on the Cunningham valuation to determine that the fair market value of 110 shares of Hall

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[10] The relevance and weight to be given to the fact that Cunningham valued Hall Chemical stock rather than Hall Holding stock is another point of contention between the parties.

Holding stock was $3.5 million. Given the existence of this dispute, although the Court holds that the defendants did fail to conduct an independent and prudent investigation to determine the fair market value of the Hall Holding shares, the Secretary's motion for partial summary judgment must be denied at this time.

IV.

For the foregoing reasons, this Court denies the defendants' motion for summary judgment, or in the alternative, partial summary judgment. The Court also denies the Secretary's motion for partial summary judgment. Further, it is hereby ordered that this case is scheduled for a status conference on February 20, 1998 at 3:00 p.m., in Chambers, 3402 Key Tower, 127 Public Square, Cleveland, Ohio. The parties are ordered to file briefs within twenty days of the date of this order, summarizing the issues that remain for trial.

IT IS SO ORDERED.

ANN ALDRICH
UNITED STATES DISTRICT

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ROBERT B. REICH, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al.,	)	
Defendants.	)	MEMORANDUM AND ORDER

Alexis M. Herman, Secretary of the United States Department of Labor, moves this Court to partially reconsider its Memorandum and Order of January 9, 1998 denying the Secretary's motion for partial summary judgment.[2] The Secretary asserts that, given the factual fmdings made by this Court in its order, the Secretary is entitled to summary judgment as a matter of law on her claims under ERISA §§406(a)(1)(A) and (D), 29 U.S.C. §§1106(a)(1)(A) and (D). Upon reconsideration, this Court agrees, and finds that the defendants did violate ERISA §406.

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action.

[2] The Secretary does not seek reconsideration of the portions of the Court's order denying the defendants' motion for summary judgment.

I.

"District courts have inherent power to reconsider interlocutory orders and reopen any part of a case before entry of final judgment." Mallory v. Evrich, 922 F.2d 1273, 1282 (6th Cir. 1991). The major grounds justifying reconsideration of interlocutory orders are an intervening change of controlling law, the availability of new evidence, or the need to correct a clear error or prevent manifest injustice. Petition of U.S. Steel Coro., 479 F.2d 489, 494 (6th Cir.), cert. denied, Fuhrman v. U.S. Steel CoM., 414 U.S. 859 (1973); 18 C. Wright, A. Miller & E. Cooper, Federal Practice & Procedure §4478 at 790. In the present case, the Secretary argues that the Court erred by adding, in effect, a "causation" element to ERISA §406 violations that is not supported by ERISA or existing case law.

II.

As this Court explained in its Memorandum and Order of January 9, 1998, "[s]ection 406 of ERISA lists several transactions that are specifically prohibited and illegal per se because of their high potential for abuse. . . . the purchase of employer securities by a plan is a prohibited transaction under §406 because of the high risk of self-dealing." Reich v. Hall Holding Co., 1998 WL 24247 at *7 (Jan. 9, 1998).[3] The Court went on to explain, however, that §408 of ERISA exempts an ESOP from the prohibited transaction rules if an ESOP's purchase of employer securities is made for "adequate consideration" as defined in §3(18) of ERISA. Id. Section 3(18) defines "adequate

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[3] This Court fully discussed the facts of this case in its January 9th Memorandum and Order, and will not restate them here. See Hall Holding, 1998 WL 24247 at * 1-3.

consideration" in the case of assets for which there is no generally recognized market as "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. §1002(18).

Adopting the standard first promulgated by the fifth circuit in Donovan v. Cunningham, 716 F.2d 1455 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984), this Court held that the defendants could prove that adequate consideration was paid for the Hall Holding stock by showing that they "conducted a prudent investigation under the circumstances to determine the fair market value of the stock purchased by the ESOP." Hall Holding, 1998 WL 24247 at *8. This standard incorporates the general fiduciary responsibility provisions of ERISA §404. Id.

This Court explicitly found that "the defendants, as the ESOP's fiduciaries, did not conduct a prudent and independent investigation to determine the fair market value" of the Hall Holding stock purchased by the Hall ESOP. Id. at *9. The Secretary argues in its motion for reconsideration that this finding alone warrants a holding that the defendants violated ERISA §406. This Court, however, held in its January 9th order that this finding alone was not sufficient to find that the defendants had violated §406. Id. Rather, by relying on language in Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995), which analyzes ERISA §404, this Court held that in order to prove a violation of §406, the Secretary must establish a causal link between the defendants' failure to conduct a prudent investigation and harm suffered by the ESOP.[4] This causal link could be established by showing

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[4] This Court relied on the following language in Kuper: a fiduciary's failure to investigate an investment decision is not sufficient to show that the decision breached a fiduciary's duty to act reasonably in an

(continued...)

that "an objective, reasonable fiduciary would have concluded, after conducting a prudent investigation, that $3.5 million was too high a price to pay for 110 shares of Hall Holding stock." Hall Holding, 1998 WL 24247 at * 10. Therefore, under this Court's prior ruling, there can be no violation of §406 if no harm or loss was suffered by the ESOP.

Upon reconsideration, the Court holds that it erred by applying Kuper, which requires a causal connection between a failure to properly investigate and a loss in order to establish a violation of §404, to its analysis of whether the defendants engaged in a prohibited transaction in violation of ERISA §406.[5]

As the Supreme Court explained in Commissioner of Internal Revenue v. Keystone Consolidated Industries. Inc., 508 U.S. 152 (1993),

> Before ERISA's enactment in 1974, the measure that governed a transaction between

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(...continued)

> effort to hold the fiduciary liable for a loss attributable to this investment decision, a plaintiff must show a causal link between the failure to investigate and the harm suffered by the plan ... In order to establish this causal link, a plaintiff must demonstrate that an adequate investigation would have revealed to a reasonable fiduciary that the investment at issue was improvident.

Kuper, 66 F.3d at 1459-60 (citations omitted).

[5] The only causation element relevant under §406 is whether the fiduciary defendant caused the plan to engage in a prohibited transaction, which is not an issue in dispute.

> a pension plan and its sponsor was the customary arm's-length standard of conduct. This provided an open door for abuses such as the sponsors's sale of property to the plan at an inflated price or the sponsor's satisfaction of a funding obligation by contribution of property that was overvalued or nonliquid. Congress' response to these abuses included the enactment of ERISA's §406(a)(1)(A), 29 U.S.C. §1106(a)(1)(A) . . . . Congress' goal was to bar categorically a transaction that was likely to injure the pension plan.

Id. at 160. Several other courts have recognized that the purpose of §406 is to alleviate the danger of self-dealing in transactions between a plan and its sponsor. See, e.g., Donovan, 716 F.2d at 1464-1465 ("The object of Section 406 was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse."); Marshall v. Kelly, 465 F.Supp. 341, 354 (W.D. Okla. 1978) ("Congress was concerned in ERISA to prevent transactions which offered a high potential for loss of plan assets or for insider abuse . . . .").

In order to allow *appropriate* transactions between a plan and its sponsor, however, Congress enacted ERISA §408, which carves out narrow exemptions from the prohibited transactions listed in §406. Congress' goal of preventing insider abuse should not be undermined by the unnecessary expansion of the scope of these narrowly carved exemptions. By holding that a plaintiff, in order to establish a violation of §406, must show a causal link between the fiduciary's failure to properly investigate an investment and loss to the plan, this Court would inappropriately expand the scope of the exemption set forth in §408(e).

Further, the Secretary now brings to the Court's attention several cases in which courts have held that proof of harm or loss resulting from a prohibited transaction is not necessary to establish a violation under ERISA §406. Etter v. J. Pease Construction Co.. Inc., 963 F.2d 1005, 1010 (7th Cir. 1992) (plan need not suffer some sort of injury for court to find that transaction is prohibited under §406); Raff v. Belstock, 933 F. Supp. 909, 916 (N.D. Cal. 1996) (whether §406(b) has been violated "does not depend on whether any harm results from the transaction"); McDougall v. Donovan, 522 F. Supp. 1206, 1215 (N.D. Ill. 1982) ("The per se nature of [§406(a)] prohibitions is emphasized by the fact that whether one of the provisions has been violated does not depend on whether any harm results from the transaction."). The defendants have not cited any contrary case law supporting their argument, (and this Court's prior holding) that a violation of §406 does not occur unless harm is caused to the plan as a result of the transaction. The defendants only cite Kuper which this Court now finds inapplicable because it dealt with the requirements of ERISA §404, not §406.

III.

Accordingly, this Court grants the Secretary's motion for reconsideration, and finds that the defendants caused the Hall ESOP to engage in a prohibited transaction in violation of §406 of ERISA, specifically 29 U.S.C. §§1106(a)(1)(A) and (D), by failing to conduct a prudent and independent investigation to determine the fair market value of the Hall Holding stock purchased by the Hall ESOP. Although it may prove to be true that the defendants caused no monetary loss to the Hall ESOP, the issue of loss goes to the appropriate remedy, not to whether a violation of §406 has occurred. The Court will determine the appropriate remedy for the defendants' violation of §§406(a)(1)(A) and (D) at trial.

IT IS SO ORDERED.

ANN ALDRICH
UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, etc.	)	1:94CV2236
	)	
Plaintiff	)	Judge Ann Aldrich
	)	(Magistrate Judge Jack
v.	)	B. Streepy)
	)	
HALL HOLDING CO., INC., et al.	)	REPORT AND
	)	RECOMMENDED
Defendants	)	DECISION OF MAGISTRATE JUDGE

STREEPY, MAG. J.

The court has referred this case for the purpose of receiving a report and recommendation concerning "the determination of the fair market value of the Hall Holding stock purchased by the Hall ESOP on September 28, 1990." (Doc. 97) The court has already found that the defendants are liable because they "caused the Hall ESOP to engage in a prohibited transaction in violation of §406 of ERISA, specifically 29 U.S.C. §§1106(a)(1)(A) and (D), by failing to conduct a prudent and independent investigation to determine the fair market value of the Hall Holding stock purchased by the Hall ESOP." Reich v. Hall Holding Co., Inc., 990 F. Supp. 955, 967 (N.D.Ohio 1998). The entire decision is incorporated by reference) as if fully rewritten herein.

The trial heard from a total of 8 witnesses. The three major witnesses were James Cunningham (Cunningham),

Karen Brown (Brown), and Robert Den Uyl (Den Uyl). Cunningham and Brown testified in support of the defendants. Den Uyl testified in support of the plaintiff. Their conflicting testimony represented a difference of more than $2 million in the evaluation of the Hall Holding stock held by the Hall ESOP.

Each of the three major witnesses has strengths and weaknesses. Cunningham is a recognized expert in evaluating companies in the specialty chemical industry, which includes Hall Chemical Company (Hall Chemical), the value of which is a primary issue. He only evaluated Hall Chemical. Cunningham has no experience in evaluating an ESOP or an ESOP minority interest such as the 9.9 percent of Hall Holding at issue herein. Brown is an expert in evaluating ESOPs; however, she was not asked to render an opinion on the value of the Hall Holding minority interest held by the Hall ESOP. Den Uyl's primary expertise is evaluating ESOPs. He has much less experience and expertise than Cunningham in evaluating specialty chemical companies; however, he was the only witness who evaluated the Hall Holding stock at issue. As a result of the above, plus other considerations, the testimony of each major witness was credited in part and not credited in part.

In summary, the following recommended findings of fact and conclusions of law conclude that the fair market value of the Hall Holding stock on September 28, 1990 was $2,731,174.75.

Findings of Fact

1. Plaintiff in this action is the Secretary of the United States Department of Labor (the Secretary). The defendants are the Hall Holding Company, Inc. (Hall Holding), David L. Goldman (Goldman), Kathleen A. Keating (Keating), George P. Ahearn (Ahearn), Michael F. Shields (Shields), and Goldman Financial Group, Inc. (GFGI).

2. GFGI owned and managed several businesses, including Hall Chemical. GFGI owns Hall Chemical through Hall Holding, a subsidiary of GFGI. The essentially exclusive asset of Hall Holding was Hall Chemical, thus, as a practical matter, the value of Hall Chemical is of great significance. Both Cunningham and Den Uyl evaluated Hall Chemical.

3. In April of 1990, First Boston Corporation (First Boston), a prominent investment bank, presented a market evaluation of many companies held by GFGI (defendants' exhibit, hereafter DX, D). One of the companies was Hall Chemical. (Id. at D76-78.)

4. Hall Chemical is a specialty chemical company. The First Boston evaluation thereof was supervised by one of its partners, Cunningham.

5. Cunningham had been specifically requested by the president of GFGI to prepare and oversee the April presentation to GFGI. (T. 89-90)

6. In April of 1990, the Hall ESOP had not yet been created by GFGI. Cunningham's April 1990 presentation was totally unrelated to the Hall ESOP.

7. During the next four months, Cunningham left First Boston, and GFGI decided (unrelated to the Cunningham departure) to create the Hall ESOP.

8. GFGI initially planned to sell the Hall ESOP ten percent of Hall Chemical and to finance that purchase on behalf of the ESOP. This transaction would leave the Hall ESOP in possession of a minority interest in Hall Chemical.

9. In late August of 1990, GFGI contacted Cunningham to perform an independent evaluation of Hall Chemical "on behalf of our soon to be formed Hall Chemical Company [ESOP]." (DX F) He was told to value the entire company. Cunningham submitted a handwritten evaluation on August 30, 1990 (DX G) and submitted an essentially identical printed evaluation on September 5, 1990 (DX H). He concluded the value, excluding net debt of $13.6 million, was $32.4 to $37.4 million. (DX G at G3; DX H at H15.) Cunningham largely based his latter evaluations on his previous evaluation in April of 1990. (T. 143)

10. Hall Chemical was evaluated by three methods, which is standard practice in the profession. Each method gave a separate range of value. The three ranges were then averaged to arrive at an overall range of value.

11. The three methods were: (1) the discounted cash flow analysis (DCF), (2) the comparable companies analysis, and (3) the comparable acquisitions analysis. (DX H at 82.) Each method relies upon a number of variable elements, most of which are different from the elements used by the other two methods, albeit there is some overlap.

12. The DCF determined fair market value by finding the present value of the projected cash flow of Hall Chemical. Cunningham estimated Hall Chemical's future

annual operating cash flow for nine years beyond 1990, based largely on management's projections. There were separate projections of various segments of the cash flow, including revenues, operating expenses and operating income for each year. (DX H at H18)

13. The present value of each projection was then calculated. The range of discount rates used to calculate present value was 11 percent to 14 percent. (DX H at H19.)

14. The result was an estimated value range of $44 million to $51 million, which included the Hall Chemical debt. (DX H at 17.)

15. The second method was the comparable companies analysis. Cunningham first selected the five publicly-traded companies which most closely compared to Hail Chemical in terms of numerous variables. Once the companies were selected, certain segments of their current financial statements, for example, sales, operating income, operating cash flow, and net income, were selected for each company. Next, ratios (also referred to as multiples) were calculated from the known data of each company. The ratios reflected the numerical relationship between each company's adjusted market value (determined largely by the known value of its publicly traded stock) and each of the selected segments of its financial statement. Once the set of ratios for each of the five companies were determined, the mean of each ratio was ascertained. The set of mean ratios was then mathematically applied to the known value of the same segments of Hall Chemical's financial statement to calculate the previously unknown value of Hall Chemical. (T. 97-98; DX H at H21-H22.)

16. It would have been inappropriate to only use data from two comparable publicly traded specialty chemical companies. (T. 98)

17. Each of the five comparable companies was much larger than Hall Chemical. Nonetheless, it would not have been proper to make a size adjustment by lowering the mean ratios because in 1990, smaller companies in the speciality chemical industry were typically growing at a faster rate than the larger companies and typically had higher multiples or ratios than the larger companies. (T. 101-02)

18. Den Uyl states a size adjustment is required based upon an IRS study. That study is not credible because, inter alia, it (1) is based upon insufficient data (one day on the stock market), (2) is based on outdated data (1957), and (3) was only intended by the IRS as a training exercise, i.e., it was never intended by the IRS to be utilized in the manner suggested by Den Uyl. On cross-examination, Den Uyl referred to subsequent studies as being "consistent" with the IRS study, but those studies were not relied upon by Den Uyl or his predecessor in drafting the expert report, and those studies were not described at trial sufficient to give them credit.

19. Using the comparable company analysis, the value range of Hall Chemical was from $43 million to $53 million, including debt. (DX H at H20.)

20. The third method, comparable acquisitions, analyzed actual known sales of other specialty chemical companies or divisions thereof which were comparable to Hall Chemical. The same multiples or ratios considered under the comparable companies method were determined for each company, and a mean was

calculated. The mean was then applied to the same segments of the known Hall Chemical financial information (such as sales, operating income, and cash flow) to arrive at the value thereof. (T. 102-03)

21. Cunningham found 19 companies which were comparable to Hall Chemical. (DX H at H24-H26.) Den Uyl concluded none of them were comparable because of size and product differences. These factors did not eliminate the companies. It was appropriate to utilize the 19 companies as comparables.

22. The value range under the comparable acquisitions method for Hall Chemical was from $44 million to $58 million, including debt. (DX G at H23.)

23. The average of the range valuations under each of the three methods was an evaluation of Hall Chemical in the range of $46 million to $51 million. (DX H at H16.)

24. To obtain the actual value, the net debt of Hall Chemical of $13.6 million was subtracted, leaving a range of $32.4 million to $37.4 million. (DX H at H15)

25. Hall Chemical's fair market value on September 28, 1990 was $35 million based upon the approximate midpoint of the range of $32.4 million to $37.4 million of Hall Chemical. However further discounts are required.

26. At the last minute, GFGI officials decided to sell shares in Hall Holding to the Hall ESOP rather than Hall Chemical. Hall Chemical was the primary asset of Hall Holding. Den Uyl thought Ahearn had a five percent interest in Hall Holding which had to be subtracted from the value of

Hall Chemical. (PX 5 at Bates No. 28.) In fact, Ahearn sought to purchase Hall Chemical from GFGI shortly after the Hall ESOP was formed, except for the 9.9 percent then held by the ESOP. He did not claim an ownership interest. (T. 272-73) There is insufficient evidence to conclude Ahearn had an interest in either Hall Chemical or Hall Holding.

27. Hall Holding had negative accounts receivable of $1,086,509.00 and liabilities of $534,636.00, which must be subtracted from the $35 million fair market value of Hall Chemical. (T. 338, 343-4?; PX 5 at 28.)

28. The resulting fair market value for Hall Holding is $33,378,855.00.

29. Cunningham was not informed that the Hall ESOP would only be purchasing a minority interest of ten percent in Hall Chemical. (T. 121) Generally, a minority interest discount should be applied because the holder of such an interest can be abused by the holder of the majority interest (T. 134), thus making the minority interest less valuable.

30. Den Uyl's suggested minority interest of 13 percent must be applied. (T. 348-50; plaintiff's exhibit, PX, 5 at Bates No. 28.) The resulting fair market value is $29,039,603.85.

31. Den Uyl's suggested marketability discount of five percent must also be applied because the market for a closed corporation is not as readily available as is a market for publicly traded stock. (T. 350; PX 5 at 30.) The resulting fair market value is $27,587,623.70.

32. The Hall ESOP purchased 9.9 percent of Hall Holding. The fair market value of that minority interest (9.9% x $27,587,623.70) on September 28, 1990 was $2,.731,174.75.

Conclusions of Law

"Fair market value" means "the price at which an asset would change hands between a willing buyer and a willing seller and the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties are able, as well as willing, to trade and are well informed about the asset and the market for such asset." Department of Labor proposed regulation relating to the definition of adequate consideration, §2510.3-18(b)(2)(i). In the context of a breach by a fiduciary in an ERISA case, the definition of fair market value is similar, i.e, it is "the price that a willing buyer would pay a willing seller, both having reasonable knowledge of the pertinent facts." Sommers Drug Stores v. Corrigan Enterprises, Inc., 79.3 F.2d 1456, 1461 (5th Cir. 1986), cert. denied, 479 U.S. 1089 (1987); see also Reich v. Valley National Bank, 837 F. Supp. 1259, 1282 (S.D.N.Y. 1993).

Determining the fair market value of a company is not an exact science, particularly in a closely held corporation. Herman v. Mercantile Bank, 143 F.3d 419, 422 (8th Cir. 1998). Indeed, it is "a very inexact science." Donovan v. Cunningham, 716 F.2d 1455, 1473 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984). Determining fair market value is a fact issue, including the issues of whether there should be marketability and/or minority interest discounts. Estate of Ford v. C.I.R., 53 F.3d 924, 926, 928 (8th Cir. 1995); Estate of Berg v. C.I.R, 976 F.2d 1163, 1165 (8th Cir. 1992). These particular discounts have often been applied. See Eyler v. C.I.R., 88 F.3d 445, 452-53 (7th Cir.

1996); Theophilos v. C.I.R., 85 F.3d 440, 449-50 (9th Cir. 1996); Estate of Hoover v. C.I.R., 69 F.3d 1044, 1047 (10th Cir. 1995).

Defendants offered much evidence and submitted legal authority which essentially seeks to reargue the liability finding of this court. In an abundance of caution, the evidence was admitted for whatever value it might have on the fair market value issue. After consideration, that evidence is of little or no relevance. The liability issue is beyond the scope of the reference.

Some non-expert testimony was admitted concerning evaluations of Hall Holding or Hall Chemical other than Cunningham's and Den Uyl's, e.g., the Leyon evaluations. The other written evaluations were not offered into evidence perhaps because such reports are not admissible. See Enaebretsen v. Fairchild Aircraft Corp., 21 F.3d 721, 728-29 (6th Cir. 1994). Under these circumstances, the non-expert testimony, which was based on inadmissible valuations, constitutes inadmissable hearsay. Accordingly, that evidence has not been considered.

RECOMMENDATION

It is recommended that the court find the fair market value on September 28, 1990 of 9.9 percent of the Hall Holding stock held by the Hall ESOP was $2,731,174.75.

Dated: December 23, 1998 Jack B. Streepy
United States Magistrate Judge

ANY OBJECTIONS to this Report and Recommendation must be filed with the Clerk of Courts within ten (10) days of receipt of this notice. Failure to file objections within the specified time WAIVES the right to appeal the District Court's order. See Thomas v. Arn, 474

U.S. 140 (1985); United States v. Walters, 638 F.2d 947 (6th Cir. 1981).

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, etc.	)	1:94CV2236
	)	
Plaintiff	)	Judge Ann Aldrich
	)	(Magistrate Judge Jack
v.	)	B. Streepy)
	)	
HALL HOLDING CO., INC., et al.	)	
	)	
	)	
Defendants	)	

ORDER

STREEPY, MAG. J.

The above matter was referred by the court for a report and recommended decision, a pretrial hearing, or other preliminary matters. This matter has now been concluded, therefore;

IT IS ORDERED that the case referral order is hereby terminated, and the case is returned to the referring judge.

Dated: December 23, 1998

Jack B. Streepy
United States Magistrate Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al.,	)	
Defendants.	)	MEMORANDUM AND ORDER

The magistrate judge issued a report and recommendation ("R&R") on his determination of the fair market value of the Hall Holding stock purchased by the Hall ESOP on September 28, 1990, finding that the fair market value was $2,731,174.75.

For the reasons that follow, the Court adopts that R&R (doc. # 143) in part and rejects it in part, finds that the fair market value of the stock was $2,450,451.00, declines the Secretary's invitation to impose a permanent injunction on the defendants, and closes this case. The Court also orders the defendants, jointly and severally, to pay the ESOP $1,049,549.00 - the difference between the amount paid by

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action.

the ESOP and the fair market value determined by this Court.

I. Background

The facts of this case are discussed thoroughly in this Court's Orders dated January 9 and March 10, 1998, and the Court need not repeat them here. *See* Reich v. Hall Holding Co., Inc., 990 F. Supp. 955 (N.D. Ohio 1998). After finding that the defendants violated § 406 of ERISA, this Court referred the case to the magistrate judge for preparation of an R&R concerning "the determination of the fair market value of the Hall Holding stock purchased by the Hall ESOP on September 28, 1990."

The defendants argue that the stock's value is $3.5 million; the Secretary argues that the stock's value is $918,000.

The magistrate judge essentially adopted the value proffered by the defendants, applied discounts to that value proffered by the Secretary, and arrived at a value in between what both parties wanted -- $2,731,174.75. Notwithstanding that "valuation is a very inexact science", all parties object vigorously to the R&R because the magistrate judge did not unilaterally adopt their valuation. Those objections included in part allegations that the magistrate judge improperly excluded evidence from that hearing. This Court held a two-day hearing on July 15-16, 1999 to permit the parties to present that evidence to the Court. The Court found much of that evidence irrelevant but admitted it so that the record is complete for purposes of appeal. The purpose of that hearing, however, was not to permit the parties to raise objections to the R&R that were not previously and timely made.

II. Objections

This Court has reviewed the evidence and testimony presented both before the magistrate judge and this Court, and rules on the parties' timely objections as follows:

A. Standard

The parties dispute the standard by which the Court determines the fair market value of the stock. The defendants allege that the fair market value of the stock is what a reasonable hypothetical fiduciary would have paid for the stock as of September 28, 1990. The Secretary alleges that the fair market value is the objective value of the stock on that date. This is a distinction without a difference.

In its Order of January 9, 1998, the Court held:

> Because Hall Chemical employees earned the ESOP contributions from Hall Chemical by performing services for Hall Chemical, the employees suffered a loss if the stock purchased by the ESOP was worth less than the full value of those contributions. In other words, if the Hall Holding stock was not worth what the ESOP paid for it, the ESOP and its participants suffered a loss under ERISA § 409.

Id. at 961. Thus the defendants are liable to the ESOP for the loss to the ESOP under § 409, where loss is the difference between the fair market value of the stock as of September 28, 1990, and the $3.5 million paid by the ESOP for the stock. Fair market value is defined as:

> The price at which an asset would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties are able, as well as willing, to trade and are well informed about the asset and the market for such asset.

Thus, the fair market value of the stock and the value of the stock as determined by a reasonable hypothetical fiduciary *looking after the interests of the ESOP* (i.e., not the defendants) should be the same. *See* Pl. Mot. In Limine (doc. # 174) at 6; Reich v. Valley Nat'l Bank, 837 F. Supp. 1259, 1283, 1286, 1289 (S.D.N.Y. 1993) (looking at fair market value from the perspective of what a "hypothetical, non-coerced buyer would pay"; "Upon proof of fiduciary duty, Plan participants must be placed in the position they would have occupied but for the breach"; "[E]ven if Valley's breach involved nothing more than paying too high a price for the stock, Valley would still be liable for the difference between the price paid and the price that should have been paid").[2]

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[2] The Secretary filed a motion in limine to exclude any evidence from the defendant concerning what a reasonable hypothetical fiduciary would pay for the stock. The Court denied this motion for completeness of the record and to allow the parties to present testimony concerning what methods reasonable hypothetical fiduciary would have used to value the stock.

To the extent, however, that the defendants interpreted that ruling as an invitation to relitigate liability, that interpretation was erroneous. In arguing that the Court should consider the evidence of a reasonable hypothetical fiduciary, the defendants cite several cases which address liability in the first instance, not loss once liability is determined. *See* Herman v. Mercantile Bank, 143 F.3d 419 (8th Cir, 1998) (addressing initial liability under § 408); Donovan v. (continued...)

B. The Percentage Used

The defendants allege that the magistrate judge should have found that the ESOP purchased 9.96%, not 9.9%, of the stock of Hall Holding. This is undisputed and the Court shall use 9.96%.

C. Range of Values

As discussed elsewhere in this opinion, to arrive at his initial valuation of the stock, the defendants' valuation professional, James Cunningham, applied three valuation methodologies and obtained a range of values for each methodology. Cunningham then took an approximate average[3] of the three ranges to arrive at one valuation conclusion for the stock: $32.4-$37.4 million. GFGI

(...continued)

Cunningham, 716 F.2d 1455 (5th Cir 1983) (cited by the defendants for the proposition that the Court should not "redetermine the appropriate amount [of the stock] for itself de novo", although that passage concerned initial liability under § 408), cert. *denied,* 467 U.S. 1251 (1984).

Both parties also introduced evidence from witnesses other than experts or those capable of valuing ESOPs or stock -- namely, George Ahearn, Kathleen Keating, David Goldman, Michael Shields James Shumaker -- apparently in an attempt to relitigate liability. The Court admitted this evidence to complete the record for purposes of appeal but did not find the majority of this evidence relevant to the issue of loss.

The defendants also filed a motion in limine to exclude rebuttal testimony concerning the hypothetical reasonable fiduciary and evidence concerning an IRS study used by Mr. Den Uyl, the Secretary's expert. The Court denied this motion primarily for completeness of the record.

[3] The defendants contest this to a certain extent. This is discussed infra at pp. 6-7 of this opinion.

officials established the value of all of the Hall Holding stock at $35 million, the mid-point of Cunningham's range. Hall Holding, 990 F. Supp. at 958.

The magistrate judge adopted Cunningham's valuation method and used that $35 million value prior to applying the discounts proffered by the Secretary, to arrive at an exact figure -- as opposed to a range of values -- for the fair market value. Notwithstanding that the magistrate judge adopted their own methodology, the defendants now allege that the magistrate judge erred in not obtaining a range of values, because valuation "is a very inexact science", and it is impossible to find an exact figure for fair market value.

This objection is without merit. The purpose of determining the fair market value is to determine the amount of money, if any, that the ESOP lost -- and the amount of money that the defendants must repay the ESOP -- because of their breach of their fiduciary duties. This amount is determined by subtracting the $3.5 million that the ESOP paid for the stock from the fair market value as determined by the Court. An exact value is necessary to determine that amount.

Even if the Court were to determine a "range of values" for the stock, the Court presumes that the defendants would determine the amount of money that they must repay the ESOP by subtracting the highest "exact" value in that range from the $3.5 million paid by the ESOP, thus using an "exact" value to their advantage to repay the lowest amount possible.

The defendants' objection is unpersuasive.

However, the Court disagrees with the magistrate judge that it should take the approximate mid-point of the range as the fair market value. Instead, the Court finds that because the defendants have violated ERISA by failing to look "with a single eye" at the ESOP transaction, the Court should take the lowest value of the range to provide the ESOP members any benefit of the doubt on the valuation.

D. Testimony/Qualifications

The magistrate judge heard testimony from several persons qualified to value ESOPs and/or stock: (1) Cunningham, the individual who had valued the Hall Chemical Company for the defendants, and who is a recognized expert in evaluating specialty chemical companies. He did not, however, value Hall Holding, the stock actually purchased by the ESOP. (Cunningham Dep. at 74-75); (2) Karen Brown, the defendants' expert in ESOP valuation who testified that the Cunningham valuation should be accepted unequivocally by the Court because a reasonable hypothetical fiduciary would have accepted it. Brown did not independently value the stock herself, however; and (3) Bruce Den Uyl, a valuation expert hired by the Secretary who critically reviewed the Cunningham valuation and proffered a different, lower valuation for the stock.

The Court finds that Cunningham and Den Uyl were both qualified to value the stock. Cunningham was more experienced in valuing specialty chemical companies but did not have experience in valuing ESOPs; nor did he value Hall Chemical with the ESOP issue in mind. (Tr. at 74-85; 135). Den Uyl was less experienced valuing specialty chemical companies but was more experienced in valuing

ESOPs. (Tr. at 294; 300-305; 506-508; Cunningham Dep. at 43-44).[4]

Given the relative strengths and weaknesses of Cunningham and Den Uyl, the decision of the magistrate judge to adopt Cunningham's initial valuation and adjust that value to account for, as proffered by Den Uyl, both the intricacies in ESOP valuation and the fact that the ESOP purchased Hall Holding stock, not Hall Chemical, is a logical method of arriving at the fair market value.[5]

The Court finds that Brown was qualified to render an opinion on what a reasonable hypothetical fiduciary would have done in valuing the stock purchased by the ESOP. (Tr. at 176-180). However, she did not actually value the stock of either Hall Holding or Hall Chemical. (Tr. at 212). Thus her testimony, while considered by the Court, is not credited as much as that of Cunningham and Den Uyl.

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[4] Den Uyl testified that in valuing chemical companies, "it's certainly helpful to understand the industry but it's not a requirement that you have spent your whole life doing it." (Tr. at 507). The Secretary therefore alleges that the magistrate judge erred in not crediting Den Uyl in full. The Court disagrees. As this Court has already stated, Den Uyl was qualified to value the company. However, as little case law exists on valuation, often the conclusion is determined in large part on the credibility and background of the witnesses who performed the valuation. Although Den Uyl performed valuations on chemical companies, Tr. at 294, Cunningham had more experience with chemical companies and was named the top specialty chemical analyst several years in a row. (Tr. at 80-81). The Court agrees with the decision of the magistrate judge to find that Cunningham had more experience in chemical companies than Den Uyl.

[5] For this reason, the Court finds the decision of the magistrate judge to accept Cunningham's discount rates in his discounted flow analysis to be proper.

E. Methodologies

Cunningham used three valuation methods for the stock: (1) the discounted cash flow analysis; (2) the comparable companies analysis; and (3) the comparable acquisitions analysis. These are described in the R&R and need not be described here. (Tr. at 90- 91; 96-97; 102-03; 196; 203;). Den Uyl agrees that these methodologies are appropriate for valuation of companies, although he disagrees with Cunningham's application of those methodologies to this valuation. (Tr. at 309).

Cunningham valued the entire Hall Chemical Company and concluded: (1) the range of values for Hall Chemical under the discounted cash flow analysis was $44 - $51 million; (2) the range under the comparable companies analysis was $43 - $52 million; and (3) the range under the comparable acquisitions analysis was $49 - $58 million. (DX H at 16). Cunningham then took an approximate average of the three methods to arrive at a "valuation conclusion" range of $46 - $51 million.

I. Erroneous Numbers Used

The Secretary alleges that Cunningham used an erroneous value of net income in his comparable companies analysis, making the adoption of his valuation erroneous. (Tr. at 710-716). Den Uyl plugged the lower net income value into Cunningham's original calculations and arrived at a corrected value of $37.6 million. The Secretary also alleges that Cunningham used an incorrect operating income for his comparable acquisitions analysis. (Tr. at 712). Den Uyl plugged the lower operating income into Cunningham's original calculations and arrived at a corrected range of values of $40.1 - $46.6 million. (Tr. at 712).

This Court does not find this argument persuasive, as the Den Uyl testimony cited by the Secretary in her brief does not contain a sufficient explanation concerning how Den Uyl arrived at these corrected values, and Cunningham testified that he used the data that was accurate to him at the time of the valuation. (Tr. at 161, 164-65; 169).

ii. Comparability

The Secretary objects to Cunningham's valuation in part because she alleges that the companies used in Cunningham's comparable acquisitions analysis were not comparable. Based on Cunningham's expertise, the Court finds that the magistrate judge was correct to credit his testimony that the companies used in this analysis were comparable. (Tr. at 103; 118-19). Den Uyl's testimony to the contrary was not persuasive, as he did not appear to possess sufficient information to make such a judgment. *See* Tr. at 383-396.

The Secretary also objects to Cunningham's valuation in part because she alleges that the companies used in his comparable companies analysis were not comparable. (Tr. at 717). Cunningham used five companies in his analysis, whereas Den Uyl used only two of those companies, finding the other three not comparable. Cunningham, however, testified that two companies would be inappropriate for the analysis because "the specialty chemical universe is somewhat diverse. Its [sic] frequently pretty hard to find an exact match and with two companies there would always be a danger of one company where there was something really very different than the other company, even though there might be some similarities. So we felt with five we would -- that gave us a broad enough

range where we took some averages." (Tr. at 97-98) (emphasis added).

Den Uyl's testimony supported Cunningham's concern about this danger. Den Uyl criticized Cunningham's valuation in part because the multiples Cunningham used in his comparable companies analysis were too large, as the companies used were larger than Hall Chemical. (Tr. at 351). Den Uyl testified that a size adjustment was necessary in that analysis because studies have shown that "for smaller companies you have lower multiples and for larger companies you have higher multiples". (Tr. at 352).

To support that argument, Den Uyl used a 1957 IRS study and testified that more recent studies also supported the conclusion in that study. (Tr. at 402-410; 525). The defendants attempted to impeach Den Uyl by arguing that of the two companies used by Den Uyl in the comparable companies analysis, the smaller company trades at a higher multiple. (Tr. 412). Den Uyl defended his position by stating "That's a very limited database" and "You can't reach a conclusion based on the two" because there are always outliers "to this kind of statistic" -- a point with which Brown agreed. (Tr. at 412; 527; 540; 612). Den Uyl did, however, also state that there was nothing inherently incorrect with using only two companies as long as a "sanity check" was performed, which he did. (Tr. 718).

Given this testimony, the Court agrees with the decision of the magistrate judge to credit Cunningham's testimony on this point.

F. Ahearn's 5% Share

Although Cunningham valued Hall Chemical, the ESOP purchased Hall Holding stock. Brown testified that this was irrelevant because, as Hall Holding's primary asset was Hall Chemical, a reasonable hypothetical fiduciary would have adopted Cunningham's valuation of Hall Chemical as the valuation of Hall Holding. The Secretary disagrees, alleging that the Cunningham valuation was too high in part because Hall Holding owned only 95% of Hall Chemical, defendant George Ahearn owning the other 5%. The magistrate judge found that insufficient evidence existed to conclude Ahearn had an interest in either Hall Chemical or Hall Holding. R&R at 9.

This Court disagrees. Den Uyl and Brown testified that Ahearn entered into a stock agreement with Hall Chemical whereby he had restricted nonvoting rights to common stock of Hall Chemical. Ahearn could not sell the stock during his term of employment, and Hall Chemical could buy back his stock at a reduced rate if he left Hall Chemical or was terminated at any time through 1993. (Tr. at 479-483; 641-42; 727).

Brown testified that although the stock had some value, the stock was restricted and therefore not worth the full 5% imputed by Den Uyl. (Tr. at 641-43). However, Den Uyl testified that the restriction only applied if Ahearn left or was terminated. Had Ahearn stayed with Hall Chemical, the stock would have been valued at a higher rate. (Tr. at 482-83; 727).

The fair market value of the Hall Holding stock purchased by the ESOP would reflect this stock at the 5% testified to by Den Uyl. In 1990, Ahearn was the president and chief operating officer of Hall Chemical. (Tr. at 257). The Court finds that a valuation professional or reasonable fiduciary would not have known at the time of the valuation

whether Ahearn would leave the company or be terminated through 1993, lessening the value of his stock.[6] Thus, the Court credits Den Uyl's testimony on this point.

G. Marketability Discount

The magistrate judge applied a 5% marketability discount to the valuation to reflect that the market for a closed corporation such as Hall Holding is not as readily available as a market for publicly traded stock. The defendants object to this discount because the ESOP contained a "put" option that would allow the members of the ESOP to sell their shares back to the company. (Tr. at 70; 288; 647). Such a discount was reasonable because to exercise this put option, an ESOP member (1) would have to wait until he or she retired from Hall Chemical; (2) might not get the cash equivalent of the stock, because the company could instead give the member a note with interest; and (3) would incur a risk, as Hall Chemical was highly leveraged and an "investor would be concerned whether [he] would be able to get paid off given the financial condition of the company". (Tr. at 340; 730). Moreover, the defendants' own expert, Brown, admitted on cross-examination that such a discount was reasonable. (Tr. at 669).

As their own expert agrees it was reasonable, the defendants' argument is unpersuasive.

H. Minority Discount

(i.) Comparable Companies

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[6] Ahearn left Hall Chemical in 1993 and started his own company. (Tr. at 256). The actual terms on which he left Hall Chemical are disputed but wholly irrelevant to the issue of loss.

The magistrate judge applied a minority discount of 13% to account for the fact that the ESOP purchased only a minority interest of 9.96% in Hall Holding. The defendants object to this discount for several reasons. First, they allege that the discount should not be applied to the comparable companies analysis because that analysis automatically yields a minority value for the company. (Tr. at 208-09; 670-71). Den Uyl agrees with that argument, and the Court shall not apply the minority discount to the comparable companies analysis. (Tr. at 349).

(ii.) Discounted Cash Flow

The defendants object to this discount as applied to the discounted cash flow analysis because Brown testified that Cunningham's discounted flow analysis "arrived directly at a minority value of Hall Chemical" because he did not make certain changes/"expense saves" that a controlling buyer would have made in his projections used in that analysis. (Tr. at 196; 209-10; 228; 233; 286; 644). However, Brown never valued the company herself. (Tr. at 233).

Moreover, Den Uyl testified that a minority discount was appropriate and Cunningham agreed that he would look for and apply a minority discount. (Tr. at 131;133-37; 207; 212; 531-32; Cunningham Dep. at 46-47; 63-64; 66; 107-08). It is also undisputed that Cunningham did not undertake such an analysis because he was not told that the ESOP would be purchasing a minority interest in the stock and that he had not valued a minority interest in an ESOP before. (Tr. at 134-35; Cunningham Dep. at 47). Cunningham attempted to counter this by stating that his discounted cash flow analysis "sort of in itself is a minority

value" because it is a "conservative approach". (Tr. at 124-25).

The Court agrees with the decision of the magistrate judge to credit the testimony of Den Uyl on this issue, as he had more experience than Cunningham in valuing ESOPs, and, unlike Cunningham and Brown, had actually valued Hall Holding with the minority interest in mind.

(iii.) Comparable Acquisitions

The defendants also object to the decision of the magistrate judge to apply a minority discount to the comparable acquisitions analysis, as they allege Cunningham's analysis also arrived at a minority value. Specifically, they allege that Cunningham deducted $7 million from the top end of the range of values of that analysis prior to "averaging" the range of values of the three methods for his ultimate valuation conclusion. (Tr. at 196; 207; 645). In short, Brown testified that Cunningham's "acquisitions value range was higher than his ultimate mathematical conclusions. So effectively a control premium was backed out. He did not go through that actual exercise but the conclusions support that." (Tr. at 645-46).

Den,Uyl testified that in the comparable acquisitions analysis, it is proper to apply a minority discount because "those are values of controlling interests in companies that people are acquiring". (Tr. at 729).

For the reasons stated in part (ii) the Court agrees with the decision of the magistrate judge to credit Den Uyl's testimony on this point.

I. Accounts Receivable and Liabilities of Hall Holding

The defendants object because the magistrate judge subtracted from Cunningham's value $1,086,509.00 in negative accounts receivable and $534,636.00 in liabilities that he believed Hall Holding had at the time of the valuation. The defendants cite to testimony of Kathleen Keating and Ahearn and to the litigation report of Brown for the argument that making the change in stock from Hall Chemical to Hall Holding was irrelevant. (Tr. 30-31; 258-59; 284-85; Def Ex. P).

In short, defendants cite testimony from two people who this Court has already found did not view this transaction "'with an eye single to the interests of the participants and beneficiaries' as required by ERISA", and another person who admittedly was retained to discuss only Cunningham's methodologies, not whether his actual calculations were correct. Hall Holding, 990 F. Supp. at 964. Moreover, in the portion of Ahearn's testimony cited by the defendants, he admits that Hall Holding had "liabilities somewhere around $500,000."

As such, the defendants' argument is not persuasive.

J. The Math

Applying these adjustments to Cunningham's valuation adopted above, the Court arrives at the following:

Calculation	Discounted Cash Flow	Comparable Companies	Comparable Acquisitions
Cunningham Value (Millions)	$44-$51	$43-$52	$49-$58
$13.6 Million Debt	$30.4-$37.4	$29.4-$38.4	$35.4-$44.4
13% Minority Discount	$26.448-$32.538	Not Applicable	$30.798-$38.628

Average of the three ranges	$28.882-$36.552
Lowest value in the range	$28,882,000.00
Value after Adjustment for negative accounts receivable and liabilities	$27,260,855.00
Value after 5% Marketability Discount	$25,897,812.25
Value after 5% Discount (Ahearn's Interest)	$24,602,921.64
9.96% Interest of the ESOP	$2,450,451.00 (rounding up to the nearest dollar)

The fair market value of the stock purchased by the ESOP is $2,450,451.00.

K. Other Issues

The defendants allege that findings of fact 8, 9, and 29 in the R&R are incorrect. The Secretary has not responded to this argument so the Court shall correct the record to reflect, as urged by the defendants, that the percentage of Hall stock to be purchased by the ESOP was made after Cunningham completed the valuation and that the actual percentage of stock purchased was recommended by legal counsel.

Finally, in reviewing the parties' deposition designations, the Court has admitted Plaintiff's Exhibit 16. However, for purposes of appeal, the Secretary should produce a copy of that exhibit that does not contain handwritten notations.

III. Permanent Injunction

The Secretary moves the Court to enter a permanent injunction against the defendants to preclude them from acting as fiduciaries or service providers to ERISA-covered plans. The Court has discretion to enter such an injunction. 29 U.S.C. § 1132(a).

This Court previously determined that the defendants violated § 406 of ERISA because "no one was evaluating the Cunningham valuation or the final stock price `with an eye single to the interests of the participants and beneficiaries'" of the ESOP. Id. at 964. Nevertheless, the Court does not find the conduct in this case to be *as egregious* as the conduct in the cases cited by the Secretary in support of her position. *See* Martin v. Feilen, 965 F.2d 660 (8th Cir. 1992) (issuing permanent injunction against defendants who engaged in several transactions over several years and were "guilty of reprehensible self-dealing"), *cert. denied sub nom,* Henss v. Martin, 506 U.S. 1054 (1993); Beck v. Levering, 947 F.2d 639 (2d Cir. 1991) (issuing permanent injunction based on facts of Lowen v. Tower Asset Management, Inc., 829 F.2d 1209 (2d Cir. 1987) (defendants caused retirement plans to lose over $20 million by investing in numerous high-risk companies from which defendants received commissions, fees, and securities in exchange for investment banking services)), *cert. denied sub nom.*, Levy v. Martin, 504 U.S. 909 (1992); Reich v. Lancaster, 843 F. Supp. 194 (N.D. Tex 1993) (entering injunction against a defendant in part because the court, after observing his demeanor, was

convinced that his "primary concern in working with the Fund was to make as much money as possible without any concern for the economic welfare of the fund"), *aff'd,* 55 F.3d 1034 (5th Cir. 1995).

The Court has also had the opportunity to observe at least two of the defendants, Keating and Ahearn, and does not find, that they breached their fiduciary duties with the intent of personal gain. Although the Court may enter an injunction absent a finding of such intent or even absent loss to the plan, Brock v. Robbins, 830 F.2d 640 (7th Cir. 1987), the Court declines to do so at this time. The Court trusts, however, that the defendants shall not violate ERISA in the future.

IV. Conclusion

The Court adopts that R&R (doc. # 143) in part and rejects it in part. The Court finds that the fair market value of the stock was $2,450,451.00 and declines the Secretary's invitation to impose a permanent injunction on the defendants. The Court also orders the defendants, jointly and severally, to pay the ESOP $1,049,549.00 - the difference between the amount paid by the ESOP and the fair market value determined by this Court. This case is now closed, and this Order is final and appealable.

IT IS SO ORDERED.

ANN ALDRICH
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al.,	)	
Defendants.	)	ORDER

The Court has filed its memorandum and order adopting in part and rejecting in part the magistrate judge's report and recommendation. The Court finds that the fair market value of the stock was $2,450,451.00, and declines the Secretary's invitation to impose a permanent injunction on. The Court also orders the defendants, jointly and severally, to pay the ESOP the defendants. $1,049,549.00 - the difference between the amount paid by the ESOP and the fair market value determined by this Court. Therefore,

IT IS ORDERED that the Court adopts the magistrate judge's report and recommendation (doe. #143) in part and rejects it in part. The Court finds that the fair market value of the stock was $2,450,451.00 and declines the Secretary's

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action.

invitation to impose a permanent injunction on the defendants.

IT IS FURTHER ORDERED that the defendants, jointly and severally, pay the ESOP $1,049,549.00 - the difference between the amount paid by the ESOP and the fair market value determined by this Court.

IT IS FURTHER ORDERED that this judgment is final and appealable.

ANN ALDRICH
UNITED STATES DISTRICT

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al.,	)	
Defendants.	)	MEMORANDUM AND ORDER

Pursuant to Federal Rule of Civil Procedure 59(e), the Secretary of the United States Department of Labor has filed a motion for reconsideration (doc. # 204) of this Court's final order dated August 10, 1999. The defendants have opposed the motion. For the reasons that follow, this Court (1) grants the Secretary's request to award the Hall ESOP prejudgment interest on the damages award, and (2) orders the parties to further brief the issue of an appropriate allocation for the total award.

I.

The facts of this case are discussed thoroughly in this Court's orders dated January 9 and March 10, 1998, and the

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action.

Court need not repeat them here. See Reich v. Hall Holding Co., Inc., 990 F. Supp. 955 (N.D. Ohio 1998). After finding that the defendants violated § 406 of ERISA, this Court referred the case to a magistrate judge for preparation of an R&R concerning "the determination of the fair market value of the Hall Holding stock purchased by the Hall ESOP on September 28, 1990." The magistrate judge conducted a hearing on the matter and issued an R&R. All parties objected to the R&R because the magistrate judge did not unilaterally adopt their position. Those objections included allegations that the magistrate judge improperly excluded evidence from that hearing. This Court held a two-day hearing on July 15-16, 1999, to permit the parties to present that evidence to the Court. On August 10, 1999, this Court adopted the R&R in part and rejected it in part, finding that the fair market value of the stock was $2,450,451.00. Accordingly, this Court ordered the defendants to pay the ESOP $1,049,549.00 - the difference between the amount paid by the ESOP for the Hall Holding stock and the fair market value of that stock. This Court also declined the Secretary's invitation to impose a permanent injunction on the defendants.

On August 24, 1999, the Secretary filed a timely motion for reconsideration of the August 10, 1999 order. The defendants have opposed the motion for reconsideration.

II.

The Federal Rules of Civil Procedure do not provide for "a motion for reconsideration." However, it is well-settled that such a motion, when filed within ten days of the entry of judgment, may be treated as a motion to alter or amend the judgment pursuant to Rule 59(e). See Huff v. Metropolitan Life Ins. Co., 675 F.2d 119, 122 (6th Cir. 1982). It is also clear that "a postjudgment motion for

discretionary prejudgment interest constitutes a motion to alter or amend the judgment under Rule 59(e)." Osterneck v. Ernst & Whinney, 489 U.S. 169, 175 (1989). A final order may be reconsidered when, for example, the Court has patently misunderstood a party, there has been an intervening change of controlling law, or there is a need to prevent manifest injustice. See Petition of U.S. Steel Corn., 479 F.2d 489, 494 (6th Cir.), cert. denied, Fuhrman v. U.S. Steel Corn., 414 U.S. 859 (1973); Braxton v. Scott, 905 F. Supp. 455, 457 (N.D. Ohio 1995). In this case, the Secretary argues that the interests of justice require (1) an award of prejudgment interest to the ESOP, and (2) a specific order that the damages award be used for the benefit of those who were participants in the ESOP at the time of the defendants' breach. Each of these contentions will be discussed in turn.

A. Prejudgment Interest

The Secretary argues that the ESOP is entitled to an award of prejudgment interest. This Court agrees. Although ERISA "does not address the propriety of awarding prejudgment interest, such interest may be awarded in the discretion of the district court." Drennan v. General Motors Coro., 977 F.2d 246, 252 (6th Cir. 1992), reh'g en banc denied, cert. denied, 508 U.S. 940 (1993). Prejudgment interest awards are not punitive in nature; rather, they are designed to compensate plaintiffs for the lost interest value of the money of which they were deprived. See Ford v. Uniroval Pension Plan, 154 F.3d 613, 620 (6th Cir. 1998).

To make the Hall ESOP fully whole, it is necessary to award prejudgment interest in this case. From September 28, 1990 until August 10, 1999, the ESOP was denied the opportunity to invest or earn interest on $1,049,549.00. This amounts to a significant loss of opportunity. This Court's August 10, 1999 order did not address the issue of

prejudgment interest simply because the Court failed to realize that a request for prejudgment interest was outstanding. Although there is no dispute that the Secretary did, in fact, request prejudgment interest on more than one occasion over the lengthy course of this litigation, the focus of the magistrate judge's R&R (i.e., the fair market value of the stock) caused this Court to overlook the prejudgment interest issue. Upon consideration, this Court concludes that an award of prejudgment interest is required to fully compensate the ESOP beneficiaries for their losses.

The Secretary argues that the appropriate rate of interest to apply is the adjusted prime rate set by the Secretary of the Treasury pursuant to 26 U.S.C. S 6621. The Secretary has submitted a calculation sheet that applies this interest rate on a quarterly basis (compounded daily) from the period between September 28, 1990 and August 9, 1999. The defendants have not objected to either the proposed interest rate, the calculation period, or the Secretary's calculations.[1] This Court finds thosefigures to be equitable and, accordingly, awards the ESOP prejudgment interest in the amount of $1,188,457.70. The total damages award then amounts to $2,238,006.70 ($1,049,549.00 for the stock plus $1,188,457.70 in prejudgment interest).

B. Allocation of Award

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[1] The defendants do oppose the granting of prejudgment interest in the first place, citing this Court's finding that the defendants' conduct was not egregious, and that at least two of the defendant did not breach their fiduciary duties with the intent of personal gain. However, because prejudgment interest in not punitive in nature, the defendants' willfulness is not particularly relevant to the question o compensation. See Drennan, 977 F.2d at 252 (because prejudgment interest is compensatory rather than punitive, court "should have considered position of the Class rather than the conduct of [the defendant]"). In this case, an award of prejudgment interest is necessary to make the ESOP whole.

The Secretary also asks for a modification of the final order to require the defendants' payment to be "delivered to the ESOP for allocation and distribution to present and former Hall Holding employees who were ESOP participants on September 28, 1990, and to their beneficiaries, in accordance with the terms of the ESOP Plan Document and the directions of the Court." Plaintiffs Memorandum in Support of Motion for Reconsideration, at 2. To ensure that whose who were participants and beneficiaries in 1990 be compensated for their losses, the Secretary asks that each participant and/or beneficiary receive "a pro rata share based on their account balances as of September 28, 1990." Id. at 6. The defendants point out that this is impossible because no one had earned any benefits under the ESOP as of September 28, 1990. That is, each participant's account balance was zero in September of 1990. The defendants do not, however, propose an alternative way to allocate the award.

This Court appreciates the Secretary's concern that those who were participants and/or beneficiaries on September 28, 1990 should benefit from the damages award. This concern seems particularly important for anyone who is no longer a participant and/or beneficiary of the ESOP, as such a person would not be able to derive any benefit from the damages award. However, it also seems that individuals who joined the ESOP between October of 1990 and August of 1999 shared in the loss of funds to the ESOP as well. Furthermore, the Secretary has not shown that it makes sense to examine the losses to the ESOP on an individual basis. The record does not show, for example, that the loss of money to the ESOP caused any participants to lose their benefits under the Plan. In short, the parties have not provided sufficient information about the functioning of the Hall ESOP to permit this Court to

resolve the Secretary's motion concerning allocation of the funds.

Because it is desirable to restore all participants and/or beneficiaries to the positions they would have obtained but for the defendants' breach, this Court will give the parties one more opportunity to brief this issue. Specifically, the Secretary is ordered to submit a proposal to the Court containing a viable allocation of the damages award within ten business days from the date of this order. In no more than five pages, the Secretary must explain how her proposed allocation is both viable and appropriately compensatory. If she adheres to her position that only participants and/or beneficiaries as of September 28, 1990 should receive monetary damages, then she must explain why those who joined the ESOP after that date were not harmed by the defendants' breach. Furthermore, the Secretary must explain how former participants and/or beneficiaries will recover any monies owed to them. The defendants will then have five business days in which to respond and/or file a counter-proposal (also not to exceed five pages) addressing the same concerns.

Of course, this Court strongly encourages the parties to discuss this issue and, if possible, stipulate to an appropriate allocation of the damages award.

III.

For the foregoing reasons, this Court grants the Secretary's motion for reconsideration regarding the award of prejudgment interest, and reserves judgment regarding the allocation of the total award. The parties are ordered to brief the allocation issue in accordance with the Court's directives above.

IT IS SO ORDERED.

ANN ALDRICH
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al.,	)	
Defendants.	)	ORDER

The Court has filed its memorandum and order granting the portion of the Secretary's motion for reconsideration pertaining to the allocation of the total award, and adopting the proposed method for allocation. Therefore,

IT IS ORDERED that the Secretary's motion for reconsideration pertaining to the allocation of the total award is granted; the proposed method, as described in the Memorandum and Order, is adopted; and the case is closed.

IT IS FURTHER ORDERED that this judgment is final and appealable.

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action.

ANN ALDRICH
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

ALEXIS M. HERMAN, Secretary of the United States Department of Labor,[1]	)	Case No. 1:94CV2236
Plaintiff,	)	
vs.	)	Judge Ann Aldrich
HALL HOLDING COMPANY, INC., et al.,	)	
Defendants.	)	MEMORANDUM AND ORDER

On September 28, 1999, this Court granted in part a post judgment motion for reconsideration filed by plaintiff Alexis M. Herman, the Secretary of the United States Department of Labor ("the Secretary"). Specifically, this Court granted the Secretary's request to award the Hall Holding ESOP ("the ESOP") prejudgment interest on the damages award, but ordered the parties to adequately brief the issue of the best method for allocating the total award. Both the Secretary and the defendants have filed briefs in response.

The Secretary recommends that the total award of $2,238,006.70 be allocated to the participants in the Hall Holding ESOP who, since September 25, 1990, have

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[1] On September 23, 1997, the Department of Labor substituted Alexis M. Herman for Robert B. Reich as the current Secretary of Labor and plaintiff in this action.

received a percentage of the 110 shares of stock the ESOP purchased on that date. The Secretary contends that each of these participants should receive a percentage of the award that is directly proportional to the percentage of the stock he or she received. Under the terms of the ESOP, the 110 shares the ESOP purchased were placed in a suspense account, and, on an annual basis, a percentage of those shares was distributed to ESOP participants. The Secretary reasons that if the ESOP really had received $3.5 million worth of stock (the amount the ESOP actually paid) instead of the $2,450,451 worth of stock it in fact received, then each participant would have received that much more stock during the annual distributions. As the Secretary states, "[b]ecause of Defendants' violations, every time an allocation of stock was made to a participant account, that participant received less than two-thirds of the stock that he or she was owed." Pl. Reply Brief, at 4.

Defendants Hall Holding Company, Inc., Goldman Financial Group, Inc., David Goldman, Michael Shields, and Kathleen Keating filed a brief in which they deny that their actions caused the participants any harm.[2] In a cramped interpretation of the concept of harm, the defendants argue that, at most, the ESOP paid more in principal and interest on the $3.5 million loan than it would have if it had borrowed only $2,450, 451 for the stock. Further, because the ESOP used company contributions to pay back the $3.5 million loan. the defendants reason that Hall Holding has, by making these contributions, already "paid back" the excessive loan

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[2] Defendant George Ahearn filed a separate response brief indicating that he took no position on how best to allocate the award among the ESOP beneficiaries. For the remainder of this order, when this Court refers to "the defendants," the term includes all defendants except Ahearn.

amounts. The defendants fail to recognize that, if they had ensured that the ESOP received $3.5 million in stock at the time of the stock purchase, then the amount of stock that was distributed annually to the participants would have been greater than it actually was.[3] Moreover, as the Secretary points out, the defendants ignore the fact that Hall Holding received an initial overpayment of $1,049,549 -- a substantial amount that the defendants could have invested and benefitted from. Finally, the defendants fail to support their argument that the award will affect the tax status of the ESOP or otherwise violate provisions of the Internal Revenue Code (IRC). The Secretary has produced several persuasive IRS rulings showing that restorative payments do not have negative consequences under the IRC.

Because the Secretary's proposed allocation method is equitable and restorative, and because the defendants have failed to propose an alternative method, this Court adopts the Secretary's proposal. Therefore, any ESOP participant and/or beneficiary who received a portion of the 110 shares of stock since September 25, 1990 shall receive (in accordance with plan documents) a percentage of the $2,238,006.70 award that is proportional to the amount of that stock he or she received. As the Secretary indicates,

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[3] Contrary to the defendants' implications, this Court never concluded that evidence of harm suffered by the individual participants was non-existent. Rather, this Court ordered the parties to produce specific evidence regarding the functioning of the ESOP so that the award could be allocated appropriately. This Court was primarily concerned that individuals who joined the ESOP after 1990 might have experienced losses in addition to those who were participants in September of 1990. This Court also sought to determine whether some of the award should have been used for purposes other than reimbursement of individual accounts. Rather than proposing an alternative, the defendants simply deny that they must pay any of the $2,238,006.70 in damages that this Court has already awarded.

> For example, if the ESOP trustees allocated to Participant X 1 of the 110 shares in 1991 and 1% in 1992, then Participant X should receive 2% of the Court's award. If Participant Y was eligible for the Hall ESOP in 1995 and was allocated.5% of the 110 shares, he/she should receive .5% of the Court's award. In this way, all participants who labored for, earned and thus shared in the allocation of the original 110 shares of stock . . . will receive the additional benefits which they were promised and to which they are entitled, with interest.

Pl. Reply Brief, at 5. In the event that not all of the 110 shares have been allocated yet, the portion of the Court's award corresponding to the unallocated amount shall be placed into the ESOP and distributed along with (and in proportion to) future distributions of the 110 shares of stock.[4]

In sum, this Court now grants the portion of the Secretary's motion for reconsideration pertaining to the allocation of the total award, and adopts the proposed method for allocation described herein.

This order is final and appealable.
IT IS SO ORDERED.

ANN ALDRICH
UNITED STATES DISTRICT JUDGE

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[4] The defendants do not dispute that the current fiduciaries of the ESOP (1) possess the data regarding the participants to whom this ruling applies, and (2) are able to perform the necessary calculations without much difficulty or expense.

Case No: 99-4142: 00- A1

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ORDER

ELAINE CHAO, Secretary, U.S. Department of Labor

Plaintiffs - Appellees

v.

HALL HOLDING COMPANY, INC.; DAVID L. GOLDMAN; KATHLEEN A. KEATING; GEORGE A. AHEARN; MICHAEL F. SHIELDS; GOLDMAN FINANCIAL GROUP, INC.

Defendants - Appellants

BEFORE: NORRIS and DAUGHTREY, Circuit Judges; ZATKOFF* Chief District Judge

Upon consideration of the petition for rehearing filed by the appellant,

It is ORDERED that the petition for rehearing be, and it hereby is, DENIED.

ENTERED BY ORDER. OF THE COURT
Leonard Green, Clerk

Filed July 18, 2002

*The Hononable Lawrence P. Zatkoff, Chief U.S. District Court Judge for the Eastern District of Michigan, sitting by designation.

DEC 20 200

No. 02-593

In the Supreme Court of the United States

HALL HOLDING CO., INC., ET AL., PETITIONERS

v.

ELAINE L. CHAO, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

The Employee Retirement Income Security Act (ERISA) prohibits a fiduciary from causing an employee benefit plan to engage in a transaction that the fiduciary knows or should know constitutes a sale or exchange of property between the plan and a party in interest. An exception to that rule allows the acquisition or sale by a plan of qualifying employer securities if the plan pays no more than "adequate consideration." When the employer securities are not publicly traded, "adequate consideration" means "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. 1002(18)(B). The question presented is:

Whether fiduciaries fail to pay "adequate consideration" for employer stock that is not publicly traded, where they fail to determine the fair market value of the stock in good faith and thereby cause losses to the plan.

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In the Supreme Court of the United States

No. 02-593

HALL HOLDING CO., INC., ET AL., PETITIONERS

v.

ELAINE L. CHAO, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-56a) is reported at 285 F.3d 415. The August 10, 1999, decision of the district court (Pet. App. 98a-116a) is reported at 60 F. Supp. 2d 755. The January 9, 1998, and March 10, 1998, decisions of the district court (Pet. App. 57a-78a, 79a-85a) are reported at 990 F. Supp. 955. The magistrate judge's report and recommended decision (Pet. App. 86a-97a) and the district court's August 10, 1999, order (Pet. App. 117a-118a) and post-judgment decisions (Pet. App. 119a-131a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 3, 2002. A petition for rehearing was denied on July 18, 2002. Pet. App. 132a. The petition for a writ of

certiorari was filed on October 15, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Employee Retirement Income Security Act of 1974 (ERISA) requires the fiduciaries of an employee benefit plan to discharge their duties with respect to the plan solely in the interest of the plan's participants and beneficiaries and, among other things, with a high degree of prudence. 29 U.S.C. 1104(a)(1)(A), (B). ERISA also prohibits a fiduciary from engaging in certain prohibited transactions, including, among other things, a sale or exchange of property between a plan and a party in interest. 29 U.S.C. 1106(a)(1)(A).[1] ERISA's prohibited transaction provision "supplements the fiduciary's general duty of loyalty to the plan's beneficiaries [in 29 U.S.C. 1104(a)] by categorically barring certain transactions deemed 'likely to injure the pension plan.'" *Harris Trust & Sav. Bank* v. *Salomon Smith Barney Inc.*, 530 U.S. 238, 241-242 (2000) (citation omitted).

An employee stock ownership plan (ESOP) is an employee benefit plan that invests primarily in stock of the employer sponsoring the plan. See 29 U.S.C. 1107(d)(5), (6). Because such an employer is a party in interest, see 29 U.S.C. 1002(14)(C), the sale of employer stock to an ESOP would be prohibited under ERISA were it not for an exemption from the prohibitions in 29 U.S.C. 1106(a). That exemption allows an "acquisition or sale by a plan of qualifying employer securities" if, among other things, the acquisition or sale is for "ade-

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[1] A party in interest includes, among others, any employer whose employees are covered by a plan, and certain related corporate entities and owners. 29 U.S.C. 1002(14)(C), (E), (G).

quate consideration." 29 U.S.C. 1108(e)(1). For employer securities that have no recognized market, "adequate consideration" means, in relevant part, "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. 1002(18)(B).

If a fiduciary breaches his duties to a plan, he is "personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary." 29 U.S.C. 1109(a). The Secretary of Labor, among others, may sue to obtain such relief. 29 U.S.C. 1132(a)(2).

2. In 1988, petitioner Goldman Financial Group, Inc. (GFGI), acquired Hall Chemical Company, a company whose stock is not publicly traded. Pet. App. 4a; Pet. 5. In 1990, GFGI decided to create an ESOP for the employees of Hall Chemical. Pet. App. 60a; see *id.* at 4a-5a. The ESOP was to be "leveraged," which means that the ESOP, upon being established, would borrow money and then use the money to buy qualifying employer securities. *Id.* at 8a n.5, 60a. The ESOP was to repay the debt from cash contributions that Hall Chemical was to make on behalf of its employees. *Id.* at 8a n.5, 58a-59a.

Petitioners George Ahearn and Michael Shields were officers of Hall Chemical and the trustees of the Hall Chemical ESOP. Pet. App. 4a, 59a-60a, 62a. They had no input into the price the ESOP was to pay for the stock, however. *Id.* at 28a-31a, 75a. Petitioner Kathleen Keating made that decision in her capacity as a GFGI employee, subject to the approval of petitioner

David Goldman, who controlled GFGI and its subsidiaries. *Id.* at 6a-7a, 75a. Keating determined that the ESOP would pay $3.5 million, a price that Goldman accepted. *Id.* at 7a.

Keating explained that the $3.5 million purchase price was based on an expert's valuation of Hall Chemical Company. Pet. App. 5a-6a, 7a. That expert, James Cunningham, had valued Hall Chemical Company as worth between $32.4 and $37.4 million. *Id.* at 6a, 92a, 102a. Keating took the mid-point of that range ($34.9 million), multiplied it by the amount of stock to be purchased (9.9%), and then rounded *up* the result ($3.4551 million) so that the ESOP paid more than the midpoint. *Id.* at 6a-7a, 32a. Keating made no downward adjustments to the $3.5 million purchase price to reflect the fact that the ESOP was purchasing only a minority interest in a privately held company, adjustments that Cunningham testified that he would have made if he had been told that the ESOP was only purchasing a minority interest. *Id.* at 24a-25a, 111a. Keating also made no downward adjustment to Cunningham's valuation to reflect the fact that the ESOP did not actually purchase shares of Hall Chemical Company, the company that Cunningham had valued. Instead, the ESOP was purchasing shares of a GFGI subsidiary (Hall Holding Company) that in turn owned Hall Chemical. *Id.* at 8a. Hall Holding was worth less than Hall Chemical because it had liabilities and "negative accounts receivable" that Hall Chemical did not have. *Id.* at 93a, 112a-113a.

As a result of Keating's determinations, the ESOP obtained a loan for $3.5 million from other GFGI pension plans and used the loan proceeds to buy 110 shares, or 9.96%, of Hall Holding Company. Pet. App. 8a, 61a. The Secretary sued petitioners, alleging that peti-

tioners were fiduciaries who had violated ERISA's prohibited transaction provision, 29 U.S.C. 1106(a)(1)(A), by having the ESOP buy stock for more than adequate consideration. Pet. App. 57a.

3. a. The district court initially denied the Secretary's motion for summary judgment on liability. Pet. App. 70a-78a. The court reasoned that the stock transaction would violate 29 U.S.C. 1106(a)(1) unless petitioners paid "adequate consideration" for it. Pet. App. 71a. The court concluded that a fiduciary does not pay "adequate consideration" unless the fiduciary, in determining the fair market value of the stock, complies with the general fiduciary requirements in 29 U.S.C. 1104(a), to act solely in the interest of plan participants and beneficiaries, for the exclusive purpose of providing them benefits, and as prudent persons would act under the circumstances. Pet. App. 71a-72a. Petitioners could not prove that they acted prudently in determining the fair market value of the stock purchased by the ESOP, the court reasoned, because none of them "was acting on behalf of the ESOP when it was determined how much the ESOP would pay for the Hall Holding stock." *Id.* at 75a.

The court also concluded, however, that a violation of 29 U.S.C. 1106(a)(1) does not occur unless petitioners' imprudence caused a loss to the plan. Pet. App. 76a. To decide whether a loss occurred, the court asked "whether an objective, reasonable fiduciary would have concluded, after conducting a prudent investigation, that $3.5 million was too high a price to pay for 110 shares of Hall Holding stock." *Ibid.* Because the parties' experts disagreed on the value of the stock, and because the court saw "probable flaws" in both experts' valuations, the court concluded that material factual

disputes on the value of the stock precluded summary judgment. *Id.* at 77a-78a.

b. On reconsideration, the court concluded that, regardless of whether a loss occurred, petitioners violated 29 U.S.C. 1106(a)(1). Pet. App. 79a-85a. Instead, the court stated that "the issue of loss goes to the appropriate remedy," and that the court would consider that issue at trial. Pet. App. 84a. To assist the court in resolving that issue, the court referred the case to a magistrate judge for a recommendation on the fair market value of the Hall Holding stock purchased by the ESOP. See *id.* at 86a.

c. The magistrate judge recommended a finding that the Hall Holding stock was worth $2,731,174.75, or $768,825.25 less than the ESOP paid for it. Pet. App. 87a. The magistrate judge based his recommendation on the valuation of Hall Chemical by petitioners' expert (Cunningham), as adjusted to reflect: the ESOP's purchase of the less valuable Hall Holding, rather than Hall Chemical, stock; the fact that the ESOP was purchasing only a minority interest; and the fact that the ESOP was purchasing shares in a closely held company that were not readily marketable. *Id.* at 92a-94a.

d. The district court adopted the magistrate judge's recommendation concerning plan losses in part, rejected it in part, and found that the fair market value of the Hall Holding stock purchased by the ESOP was $2,450,451.00, or $1,049,549.00 less than the ESOP paid for it. Pet. App. 98a-118a. Like the magistrate judge, the district court accepted the valuation of Hall Chemical Company by petitioners' expert Cunningham as the starting point for the valuation. *Id.* at 105a. Rather than take the "approximate mid-point" of Cunningham's range of values ($32.4 million to $37.4 million), however, the district court took the lowest value of the

range "to provide the ESOP members any benefit of the doubt on the valuation." *Id.* at 104a. The court also corrected a mathematical error of the magistrate judge, but otherwise accepted his recommended adjustments to Cunningham's valuation. *Id.* at 102a, 105a-113a.

The district court did not "refuse[] to consider evidence on what price a hypothetical prudent fiduciary would have paid for the Hall ESOP stock," as petitioners assert. Pet. 7.[2] The court considered petitioners' evidence but did not credit it as much as Cunningham's because the expert they proffered (Karen Brown) "did not actually value the stock of either Hall Holding or Hall Chemical," while Cunningham did. Pet. App. 105a; see also *id.* at 113a (Brown was admittedly "retained to discuss only Cunningham's methodologies, not whether his actual calculations were correct"). The court also effectively found that the fair market value of the stock ($2,450,451) was what a hypothetical prudent fiduciary, acting in accordance with ERISA's duty of loyalty to participants, would have paid for the stock. See *id.* at 100a (whether the court used "reasonable hypothetical fiduciary" standard or "objective value" standard for determining fair market value of the stock was "a

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[2] Petitioners incorrectly assert that the magistrate judge "declined to consider the only evidence presented on what a hypothetical reasonable fiduciary would have paid." Pet. 7. That evidence came from Karen Brown, who testified on behalf of petitioners. See Pet. App. 104a. The magistrate judge considered Brown's testimony. See *id.* at 87a (noting that "[e]ach of the three major witnesses has strengths and weaknesses"; observing that of the three, "Brown is an expert in evaluating ESOPs," but "was not asked to render an opinion on the value of the Hall Holding minority interest held by the" ESOP, and concluding that therefore "[t]he testimony of each major witness was credited in part and not credited in part.").

distinction without a difference"); *id.* at 101a ("the fair market value of the stock and the value of the stock as determined by a reasonable hypothetical fiduciary *looking after the interests of the ESOP* (*i.e.*, not [petitioners]), should be the same").

4. In the court of appeals, petitioners argued that the district court erred by granting summary judgment when material factual disputes existed on the question of whether they violated their fiduciary duties and by holding them liable for a violation of 29 U.S.C. 1106(a)(1) without considering what a reasonable hypothetical fiduciary would have paid for the stock purchased by the ESOP. Pet. App. 17a-18a. Petitioners did not, however, challenge the district court's calculation of losses based on its determination of the stock's value. See Appellants' C.A. Br. 22-23, 43-50. Instead, they argued that the ESOP's participants were not harmed by the overpayments, that giving them the cash difference between the $3.5 million paid by the ESOP and the $2,450,451 fair market value of the stock would be to provide benefits the participants never earned or expected, and that the Internal Revenue Code barred such an award. *Id.* at 43-50; Pet. App. 51a-55a. The court of appeals rejected all of those arguments.[3]

a. The court concluded that no material issues of fact existed as to whether petitioners breached their fiduciary duties, for two reasons. Pet. App. 23a-33a. First, the court reasoned that a fiduciary cannot rely on an

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[3] The court of appeals also considered and rejected arguments that GFGI was not a proper party defendant and that petitioners Hall Holding and Goldman were not fiduciaries. Pet. App. 18a-23a. Petitioners do not challenge the court's decision on those issues.

expert's valuation of a company unless the fiduciary, among other things, gives the expert complete and accurate information and makes certain that reliance on the expert's advice is reasonably justified under the circumstances. *Id.* at 25a-26a. Petitioners failed to do either, the court reasoned. *Id.* at 26a-27a. The court also concluded that petitioners had committed "clear violations" of their fiduciary duties by the "uniquely careless and haphazard manner in which the Hall Chemical ESOP was created." *Id.* at 32a. In particular, the court noted that the ESOP's trustees were not involved in setting the price the ESOP would pay for the stock it purchased, and that the person primarily involved in setting the price (petitioner Keating) used a valuation of the wrong company, charged the ESOP extra by rounding up the purchase price, and otherwise failed to act in the interests of the ESOP. *Id.* at 28a-33a.

b. Based on statutory language, the court of appeals concluded that petitioners violated 29 U.S.C. 1106(a)(1)(A) because, whether or not a "hypothetical reasonable fiduciary" would have paid as much, "defendants did not make a good faith determination as to the price of the Hall Holding stock." Pet. App. 40a; see generally *id.* at 33a-51a. The court reasoned that 29 U.S.C. 1106(a)(1) prohibits transactions in which an employee benefit plan purchases stock from an employer, that the exception to this prohibition in 29 U.S.C. 1108(e) applies only if the purchase is for "adequate consideration," and that "adequate consideration" in the case of a closely held corporation such as Hall Holding is defined by 29 U.S.C. 1002(18)(B) to mean "the fair market value of the asset as determined in good faith by the trustee." Pet. App. 38a. The definition of "adequate consideration" thus has "two distinct parts,"

the court reasoned: "First, there is the 'fair market value' part, then there is the 'as determined in good faith by the trustee' part." *Ibid.* Because petitioners did not engage in a good faith determination of fair market value, the court concluded that they did not pay "adequate consideration" under the ERISA definition of that term. *Id.* at 40a-41a.

Accordingly, the court rejected the position of the Eighth Circuit majority in *Herman* v. *Mercantile Bank, N.A.*, 143 F.3d 419 (1998). Pet. App. 34a-38a. In *Mercantile Bank*, the court concluded that "[e]ven if a trustee fails to make a good faith effort to determine the fair market value of the stock, 'he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway.'" 143 F.3d at 421 (citation omitted). The Sixth Circuit in this case rejected that analysis because it "gives no weight to the good faith determination under [29 U.S.C. 1002(18)(B)]." Pet. App. 38a.

The court of appeals also rejected petitioners' argument that the Secretary had to prove that a fiduciary violation caused harm to the plan to establish an ERISA violation. It explained that 29 U.S.C. 1106(a)(1) creates categories of per se violations requiring no proof of harm to the plan. Pet. App. 43a-44a. Accordingly, the court distinguished its earlier decision in *Kuper* v. *Iovenko*, 66 F.3d 1447 (6th Cir. 1995), which held that ESOP fiduciaries did not violate ERISA's prudence requirement, 29 U.S.C. 1104(a)(1)(B), by continuing to hold employer securities, where the plaintiffs had failed to prove that a reasonable fiduciary would have sold the stock and diversified into other investments. Pet. App. 41a-43a. Because *Kuper* considered only a violation of 29 U.S.C. 1104, it does not require reading a causation element into 29 U.S.C. 1106, the

court stated, "and such a reading is far beyond the scope of the issues presented in that case." Pet. App. 43a.

c. Having determined liability, the court rejected petitioners' challenge to the district court's monetary award because their arguments were "based upon faulty premises" and lacked "any authority for their claims." Pet. App. 51a. As discussed above, petitioners argued that when the ESOP paid $3.5 million for stock worth $2,450,451, the ESOP and its participants were not harmed. The court of appeals explained that the overpayment did harm the ESOP and its participants because the ESOP incurred more debt than it should have incurred and therefore the participants had to wait longer to become fully vested in the stock and received a smaller return on the stock than they should have received. *Id.* at 52a-55a. Petitioners also argued that giving participants the amount of the overpayment ($1,049,549, plus interest) would constitute benefits that the participants never earned or expected or could legally obtain under the Internal Revenue Code. *Id.* at 55a. It "is simply not true" that the benefits were not earned, the court stated, because "benefits such as an ESOP are not a gratuity . . . but a form of deferred wages." *Id.* at 55a (internal quotation marks omitted). The court added that petitioners had provided no authority to show that the Internal Revenue Code prohibited an award within the district court's wide latitude to remedy ERISA breaches of fiduciary duty. *Id.* at 55a-56a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court. Although the decision below disagreed with the analysis

the Eighth Circuit used in *Herman* v. *Mercantile Bank, N.A.*, 143 F.3d 419 (1998), the result in this case would be the same under either analysis, making further review of the asserted circuit conflict unnecessary. Petitioners' other asserted conflicts do not exist. The decision below also creates none of the "dangerous uncertainty in the area of ESOP jurisprudence" that petitioners posit. Pet. 18. Further review by this Court therefore is not warranted.

1. The court of appeals correctly concluded that petitioners violated ERISA in purchasing the Hall Holding stock for $3.5 million on behalf of the ESOP. As discussed above, the court followed a three-step analysis. First, the court concluded that petitioners had not engaged in a good faith investigation into the fair market value of the Hall Holding stock purchased by the ESOP. Second, the court concluded that the stock purchase was therefore a prohibited transaction under 29 U.S.C. 1106(a)(1)(A) because petitioners' failure to investigate in good faith meant that the stock purchase was not for "adequate consideration," as required for petitioners to obtain an exemption from Section 1106(a)(1)(A). Third, the court upheld the district court's calculation of plan losses caused by petitioners' violation of ERISA because petitioners did not challenge those calculations but instead made arguments that "would confound any rational investor," Pet. App. 52a, were "baffling," *id.* at 53a, and "simply not true." *Id.* at 55a.

The court of appeals' analysis is correct. Section 1106(a)(1) of ERISA "categorically bar[s] certain transactions deemed 'likely to injure the pension plan.'" *Harris Trust & Sav. Bank* v. *Salomon Smith Barney Inc.*, 530 U.S. 238, 241-242 (2000) (citation omitted). The sale of stock between the ESOP and Hall Holding

Company is one such transaction because Hall Holding is a party in interest to the ESOP, see 29 U.S.C. 1002(14)(C), (E), and prohibited transactions include a "sale or exchange * * * of any property between the plan and a party in interest." 29 U.S.C. 1106(a)(1)(A). Thus, ERISA prohibited the stock sale unless an exemption permitted it.

The exemption at issue here, the terms of which the court decided were not satisfied, permits an "acquisition or sale by a plan of qualifying employer securities" if, among other things, the acquisition or sale is for "adequate consideration." 29 U.S.C. 1108(e)(1). For stock that is not publicly traded, such as the Hall Holding stock, "adequate consideration" means, in relevant part, "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. 1002(18)(B).

The definition of "adequate consideration" therefore requires two things, as the court said: fair market value, and "good faith by the trustee or named fiduciary" in making the determination of fair market value. Petitioners failed to establish that the "good faith" requirement had been met, both because the trustees of the ESOP had no input into the price the ESOP was to pay for the stock and because the persons who did determine the price were not acting in the interests of the ESOP and did not provide their expert with all the information he needed to make a proper evaluation. Pet. App. 25a-26a, 28a-33a, 75a-76a. Accordingly, petitioners failed to establish that the stock sale was exempt from 29 U.S.C. 1106(a)(1)(A)'s prohibition on such sales.

Petitioners do not dispute that they failed to undertake a good faith investigation into the fair market value of the stock purchased by the ESOP. Nor do they

challenge the court's calculation of losses to the ESOP. Instead, they argue that because valuation professionals may not reach the same conclusion as to the value of stock in a closely-held company, the test for "adequate consideration" should be deemed satisfied if the price an ESOP fiduciary pays for such stock is "objectively reasonable—that is, consistent with what a hypothetical prudent fiduciary would pay." Pet. 20. Petitioners assert that, if that test is satisfied, "there is no prohibited transaction, no loss to the plan, and no monetary damages may be assessed against the fiduciary even if its investigation was imperfect in some manner." Pet. 21.

Petitioners' arguments are incorrect. First, petitioners overlook the fact that the amount they paid was *not* objectively reasonable. Second, although valuation of a closely-held company is an inexact science, that is not a reason to disregard the statutory definition of "adequate consideration," which requires more than a determination of fair market value. That definition also includes a requirement that the plan's fiduciaries conduct a good faith investigation because such an investigation ensures that, despite uncertainties as to the stock's value, the fiduciary has attempted to get the best possible price for the ESOP. Eliminating the good faith requirement would allow fiduciaries to do what petitioners did here: They could act on behalf of the seller rather than on behalf of the ESOP, and charge the ESOP extra by rounding up numbers. See Pet. App. 33a. They could also rely on a valuation that, because it omitted factors that lowered the value of the stock that was acquired, "it is difficult to believe that any prudent person would use." *Ibid.* Breaching fiduciaries should not be allowed to argue that the losses found by the court to have been caused by their errors

should be excused because some "hypothetical prudent fiduciary" might have reached the same result.

Indeed, courts have held the prudence standard to be violated where the fiduciary failed to conduct an adequate investigation even if, unlike here, that conduct caused no loss to the plan. In that circumstance, the fiduciary may still be liable for "appropriate injunctive relief such as removing the offending trustees from their positions." *Brock* v. *Robbins*, 830 F.2d 640, 647 (7th Cir. 1987); *Fink* v. *National Sav. & Trust Co.*, 772 F.2d 951, 961, 962 (D.C. Cir. 1985) (Scalia, J., concurring) ("[b]reach of the fiduciary duty to investigate and evaluate would sustain an action to enjoin or remove the trustee," but would "not sustain an action for the damages arising from losing investments"); see 29 U.S.C. 1109(a) (remedies for breach of fiduciary duty include "such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary").

For those reasons, petitioners err in suggesting that proof of loss must be shown to establish a violation of 29 U.S.C. 1106. Furthermore, petitioners are incorrect in arguing that "[t]he only evidence in this case concerning causation was that the price paid by the Hall ESOP fiduciaries was well within the range of value that a hypothetical prudent fiduciary would have paid." Pet. 21. There was ample evidence to the contrary, which the district court credited in determining plan losses. See Pet. App. 104a-114a. The district court also effectively found that the fair market value of the stock ($2,450,451) was what a hypothetical prudent fiduciary would have paid for the stock. See *id.* at 100a (whether the court used "reasonable hypothetical fiduciary" standard or "objective value" standard for determining fair market value of the stock was "a distinction without a

difference"); *id.* at 101a (fair market value "should be the same" as the value of the stock "determined by a reasonable hypothetical fiduciary *looking after the interests of the ESOP*"). Thus, there is no merit to petitioners' argument that the court of appeals "concluded that the Hall ESOP suffered a loss simply because the District Court determined a lower value for the Hall Holding stock than did Petitioners (or the hypothetical prudent fiduciary or, for that matter, the Magistrate Judge)." Pet. 8-9.

2. a. Petitioners argue that review should be granted because the decision below conflicts with the Eighth Circuit's decision in *Mercantile Bank*. Pet. 9, 11-13. There is some tension between the treatment of the "hypothetical prudent fiduciary" in the decision below and in *Mercantile Bank*. That tension, however, is irrelevant to the result in this case and does not amount to a conflict in the courts of appeals warranting this Court's review.

In *Mercantile Bank*, the Secretary alleged that a fiduciary had violated ERISA by failing adequately to investigate the value of closely-held stock and by purchasing the stock for more than its fair market value. 143 F.3d at 421. The district court found no violation because "the fair market value of the stock, whatever it was precisely, was sufficiently close to what [the fiduciary] paid that, even if [the fiduciary] did overpay slightly, [the fiduciary] had no reason to know that he was overpaying." *Id.* at 422. In affirming the district court, the Eighth Circuit reasoned that, although an ESOP may purchase stock only for "adequate consideration," a trustee who fails to make a good faith effort to determine the fair market value of the stock is "insulated from liability if a hypothetical prudent fiduciary would have made the same decision

anyway." *Id.* at 421 (quoting *Roth* v. *Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994)). Construing the district court's decision in that case to have found that a hypothetical prudent fiduciary "could have and would have paid what [the actual fiduciary] paid for the stock," and reviewing that finding for clear error, the Eighth Circuit affirmed the district court's decision. *Id.* at 422.

In the instant case, the court of appeals disagreed with the Eighth Circuit's view that the statutory requirement of "adequate consideration" is satisfied regardless of the fiduciary's good faith so long as a hypothetical prudent fiduciary "would have made the same decision anyway." Pet. App. 36a (citations omitted). The court of appeals, however, did not disturb the district court's finding that petitioners' conduct caused losses to the ESOP because a "hypothetical prudent fiduciary" would not have paid as much for the company's stock. Thus, the court of appeals' rejection of the "hypothetical prudent fiduciary" standard in determining whether petitioners violated ERISA is irrelevant to the result in this case; whether that standard was applied, as in *Mercantile Bank*, as a touchstone in determining the existence of an ERISA violation, or, as here, in determining whether the plan incurred losses from the violation, the result would be the same: petitioners would be liable for a fiduciary breach and have to pay for $1,049,549 in plan losses.

Accordingly, although the difference between the Sixth and Eighth Circuits could be of significance in a case in which there is no proof of loss and the only remedy sought is the removal of the fiduciary, it has no significance in a case like this, in which there is concrete proof of loss. In a case such as this, both courts would agree that there was a violation of ERISA, that damage

occurred, and that the fiduciary is liable for damages to make good to the plan for the loss. See *Mercantile Bank*, 143 F.3d at 421-422; *id.* at 423-428 (Bright, J., dissenting). Accordingly, further review in this case to resolve the differing analyses applied by the Sixth and Eighth Circuits would be unwarranted.

b. Petitioners also argue that the decision below conflicts with the Seventh Circuit's decision in *Robbins*. That is incorrect, because *Robbins* did not decide the issue presented here and in fact supports the decision below.

In *Robbins*, fiduciaries failed properly to investigate an insurance contract they obtained for an ERISA plan. 830 F.2d at 642, 646. The Secretary alleged that they violated ERISA's prudence requirement, 29 U.S.C. 1104(a)(1)(B), as well as a prohibited-transaction provision that forbids "furnishing of goods, services, or facilities between the plan and a party in interest," 29 U.S.C. 1106(a)(1)(C). *Robbins*, 830 F.2d at 643-644. The district court concluded that the Secretary failed to establish either violation because the fees paid by the plan for the contract were objectively reasonable and the plan suffered no losses. *Id.* at 645. "In essence, the district court concluded that if a trustee enters into a contract with a fee provision with which a hypothetical prudent trustee would also agree, then the trustee does not violate his duties under ERISA even if, when entering into the contract, the trustee has no idea whether or not the provision of the contract is reasonable." *Id.* at 646.

The court of appeals in *Robbins* affirmed the finding that there had been no prohibited transaction. *Robbins*, 830 F.2d at 644-645. The court relied on an exemption from the prohibited transaction provision at issue in that case, for "reasonable arrangements with a

party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor." *Id.* at 644 (quoting 29 U.S.C. 1108(b)(2)). Because the court of appeals agreed with the district court that the fees paid under the contract were objectively reasonable, it held that the fiduciaries could rely on that exemption. 830 F.2d at 644-645.

The court of appeals in *Robbins*, however, reversed the district court's conclusion that the fiduciaries had not violated ERISA's prudence requirement. *Robbins*, 830 F.2d at 646-648. The court agreed with the district court that "[i]f trustees act imprudently, but not dishonestly, they should not have to pay a monetary penalty for their imprudent judgment so long as it does not result in a loss to the Fund." *Id.* at 647. But, quite logically, it held that they could be liable for appropriate equitable relief even if there was no monetary loss as a result of the imprudence. *Id.* at 647-648.

The holding in *Robbins* on the prohibited-transaction issue creates no conflict with the decision below because the court in *Robbins* construed a materially different ERISA exemption. The provision at issue in *Robbins* allows contracts between a plan and a party in interest "if no more than reasonable compensation is paid therefor." 29 U.S.C. 1108(b)(2). That provision has no requirement that reasonableness be determined in good faith by the fiduciary. The "adequate consideration" provision at issue here has such a good faith requirement. See 29 U.S.C. 1002(18)(B). The Seventh Circuit's interpretation of the service provider exemption in 29 U.S.C. 1108(b)(2) is thus entirely consistent with the Sixth Circuit's interpretation of the "adequate consideration" definition in 29 U.S.C. 1002(18)(B).

Moreover, the Seventh Circuit's holding in *Robbins* on the prudence issue supports the Sixth Circuit's decision here. Both courts held that the "hypothetical prudent fiduciary" concept is not a defense to liability under ERISA, even if it may be relevant in assessing plan losses.

c. Petitioners also argue that the court of appeals construed 29 U.S.C. 1106(a) not to have a causation requirement, and that the decision below therefore conflicts with appellate decisions requiring proof of causation of loss to a plan as a prerequisite to imposing monetary liability on an ERISA fiduciary for violations of 29 U.S.C. 1104. Pet. 10, 15-18. In their view, the court below departed from those cases by construing the prohibited transactions in 29 U.S.C. 1106(a) "to be 'per se' violations of ERISA as to which liability for monetary damages may be established in the absence of causation," Pet. 16, and created a conflict with *Donovan* v. *Cunningham*, 716 F.2d 1455 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984), and *Robbins* because those cases require that 29 U.S.C. 1106(a) be construed the same way as 29 U.S.C. 1104(a). Pet. 10, 17-18.

Petitioners' premise—that the court below allowed liability for monetary damages to be imposed in the absence of causation—is incorrect. As discussed above, the court held first that a showing of "causation" is not required to establish a violation under 29 U.S.C. 1106(a). Pet. App. 41a-44a. Addressing monetary liability, however, the court then went on to consider and reject petitioners' attempt to establish that the violation caused no harm to the ESOP or its participants. *Id.* at 51a-56a. The court thus found that losses had been caused by the breach and measured the damages accordingly. The court's decision is therefore consistent with decisions of other courts of appeals that have

imposed monetary liability on a fiduciary only for plan losses caused by a breach of the fiduciary's duty under various ERISA provisions.[4]

Moreover, neither *Robbins* nor *Cunningham* held that cases under 29 U.S.C. 1106(a) must be analyzed the same way as cases under 29 U.S.C. 1104(a). Petitioners' quotation from *Robbins* for that proposition is in fact a summary of the district court's reasoning in *Robbins*, which the Seventh Circuit rejected. See *Robbins*, 830 F.2d at 644 (quoted passage), 647-648 (Seventh Circuit holding that fiduciaries violated 29 U.S.C. 1104(a) even though they did not violate 29 U.S.C. 1106(a)). In *Cunningham*, the Fifth Circuit held that a fiduciary's obligation under 29 U.S.C. 1104(a) to act prudently is incorporated into the "good faith" part of the definition of "adequate consideration" in 29 U.S.C. 1002(18)(B). 716 F.2d at 1466-1468. The court did not hold, as petitioners appear to assume, that the prohibited transaction provisions should incorporate a loss-causation requirement from 29 U.S.C. 1104(a).

3. Finally, the court's decision in this case creates no "dangerous uncertainty in the area of ESOP jurisprudence." Pet. 18. Decisions of other courts of appeals have made clear to ESOP fiduciaries many of the requirements for valuing stock in a closely held company.

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[4] See Pet. 15 n.4 (citing *Silverman* v. *Mutual Ben. Life Ins. Co.*, 138 F.3d 98, 104 (2d Cir.), cert. denied, 525 U.S. 876 (1998); *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 445 (3d Cir.), cert. denied, 519 U.S. 810 (1996); *Elmore* v. *Cone Mills Corp.*, 23 F.3d 855, 864 (4th Cir. 1994) (en banc); *Physicians Healthchoice, Inc.* v. *Trustees of Auto. Employee Ben. Trust*, 988 F.2d 53 (8th Cir. 1993); *Diduck* v. *Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 279 (2d Cir. 1992); *Ironworkers Local No. 272* v. *Bowen*, 695 F.2d 531, 536 (11th Cir. 1983); *Cosgrove* v. *Circle K Corp.*, 915 F. Supp. 1050, 1066 (D. Ariz. 1995), aff'd, 107 F.3d 877 (9th Cir. 1997) (Table)).

See, *e.g.*, *Howard* v. *Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996), cert. denied, 520 U.S. 1237 (1997); *Cunningham*, 716 F.2d at 1467-1468; see also *Reich* v. *Valley Nat'l Bank*, 837 F. Supp. 1259, 1272 (S.D.N.Y. 1993). The court below followed those decisions. See Pet. App. 25a-26a (adopting requirements, set out in *Howard*, that an ESOP fiduciary must follow when relying on an expert's valuation); *id.* at 39a-40a (following *Cunningham* and *Valley National Bank*, and plain statutory language, in requiring a fiduciary to undertake a good faith determination of fair market value).

Nothing in the court's decision changes the rule, recognized by the Department of Labor, that ESOP fiduciaries receive "some leeway in the area of ESOP valuations." Pet. 20; see 53 Fed. Reg. 17,632, 17,633 (1988).[5] That leeway applies, however, only to fiduciaries who act in good faith, *i.e.*, those who undertake a prudent and independent investigation in valuing the stock of a closely-held company. Pet. 20 Where, as here, fiduciaries fail to act in good faith, they are entitled to less latitude.

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[5] As petitioners note (Pet. 19 n.6) the Department proposed a regulation that was never finalized. Nevertheless, the proposed regulation "is widely considered and followed." *Montgomery* v. *Aetna Plywood, Inc.*, 39 F. Supp. 2d 915, 919 n.1 (N.D. Ill. 1998).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 02-593

IN THE

Supreme Court of the United States

Hall Holding Company, Inc., David L. Goldman, Kathleen A. Keating, George P. Ahearn, Michael F. Shields, Goldman Financial Group, Inc.,
Petitioners,

v.

Elaine Chao, Secretary, U.S. Department of Labor,
Respondent.

ON PETITION FOR A WRIT OF *CERTIORARI*
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR A WRIT OF *CERTIORARI*

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Petitioners believe that this case presents an opportunity for the Court to address a core legal issue under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") – whether a plaintiff must prove causation in order to establish liability and/or to assess damages against a fiduciary who has allegedly breached his duties under ERISA. With all due respect to the Government, we do not believe that it has succeeded either in explaining why causation should not be an element of proof, nor in justifying why the Court should ignore the conflict between the Circuits created by the decision below. Accordingly, we see no reason to respond further on this point.

However, we do think it important to comment on the Government's response to our argument that the question presented directly affects the way courts will address the ever-increasing numbers of cases involving employee stock ownership plans ("ESOPs") because that response illustrates, and is bound to exacerbate, a fundamental problem with the decision below.

The courts have long held that, in order to establish liability or assess damages in an ESOP case, the plaintiff must prove that the defendant fiduciary caused a loss to the ESOP by paying more than a hypothetical reasonable fiduciary would have paid. Equally important was the notion that the task of the court was "not to redetermine the appropriate amount [of the fair market value] for itself *de novo*." *Donovan v. Cunningham*, 712 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251(1984).

At least that was the accepted standard -- the standard now is anyone's guess. For the Sixth Circuit squarely held that, since proof of causation is not a requirement, there is no reason to even consider what a hypothetical reasonable

fiduciary would have paid for the stock and the court may assess liability and damages if an ESOP fiduciary does not pay the exact price for closely-held ESOP stock that the district court has determined in a *de novo* valuation.

It is bad enough that a *de novo* valuation is precisely what a court should not do according to the Fifth Circuit in *Cunningham*, and that reading causation out of the statute by ignoring what a reasonable fiduciary would have done is directly contrary to the reasoning of the Eighth Circuit in *Herman v. Mercantile Bank, N.A.*, 143 F.3d 419 (8th Cir.), *reh'g en banc den.* 1988 U.S. App. LEXIS 20331 (1998). What is worse is that, in trying to explain away the Sixth Circuit's departures from accepted law, the Government has only succeeded in adding more confusion.

We read the Government's argument as follows. It begins by claiming that there is no difference between the valuation done by the district court and the amount a reasonable fiduciary would have paid. This is a bold attempt to resolve what it refers to as the "tension" between the Sixth and Eighth Circuits concerning the need to prove causation, but it lands them squarely at odds with the reasoning in *Cunningham* that, since valuation is an inexact science, there is no one number, including a court's *de novo* valuation, that represents what a reasonable fiduciary would have paid. Recognizing that problem, the Government switches gears and acknowledges that it has long held that, because there is a range of value in any valuation, fiduciaries must receive "some leeway in the area of ESOP valuations." Opp. 22. We have no quarrel with that proposition since it is consistent with the approach of the Eighth Circuit in *Mercantile Bank*, but we fail to see how the Government can espouse that position and still support the decisions below since there is no "valuation leeway" recognized in those decisions and indeed no attempt whatsoever to base liability

on any sort of range. The Government was no doubt thinking the same thing since it then added that, while fiduciaries are entitled to "some leeway," those who do not act in good faith are entitled to "less latitude."

We do not believe that the law is served by a "standard" that affords fiduciaries with no latitude, "some" latitude and "less" latitude – all at the same time. But that is the consequence of reading causation out of the statute in this important area of the law. We urge the Court to resolve the conflict created by the decision below and endorse the approach of the Eighth and Fifth Circuits that a plaintiff must prove that the price paid for ESOP stock was outside the range of value that a reasonable fiduciary would have paid in order to establish causation under ERISA.

Conclusion

We submit that it is important that the Court issue the writ of *certiorari* to resolve the split in the Circuits because this case involves an element of proof in every prohibited transaction case under ERISA. Moreover, the question is presented in a manner that is well suited to this Court's consideration since a resolution does not require reference to the facts of this case and there is no disagreement about what a causation standard involves. It is clear from the Government's brief that it agrees that causation requires a court to consider whether a defendant's actions caused loss by comparing the result of its actions to what a hypothetical reasonable fiduciary would have done. Finally, the fact that the issue arises in an ESOP case would provide additional benefit to the courts below. Once again, there is no disagreement about the content and practical effect of a causation standard in this context. If causation is required, the hypothetical reasonable fiduciary must be considered and that means using a range of value; if causation is not

required, the court will proceed to compare the price to its own *de novo* valuation.

In sum, this case presents an ideal set of circumstances for this Court to resolve a conflict in the Circuits concerning a core issue of ERISA jurisprudence.

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